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IN THE

Supreme Court of the United States

OCTOBER TERM, 1981

AMERICAN PAPER INSTITUTE, INC.,

Petitioner,

—v.—

AMERICAN ELECTRIC POWER SERVICE CORPORATION, CONSOLIDATED EDISON COMPANY OF NEW YORK, INC., COLORADO-UTE ELECTRIC ASSOCIATION, INC., FEDERAL ENERGY REGULATORY COMMISSION, *et al.*,

Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

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QUESTIONS PRESENTED

1. Whether, in holding that §§ 210 and 212 of the Federal Power Act provide the exclusive means by which the Federal Energy Regulatory Commission may require utilities to interconnect with qualifying cogeneration and small power production facilities to implement § 210 of PURPA, the Court of Appeals improperly frustrated clearly expressed Congressional intent when it rejected the Commission's contemporaneous construction of these statutes?

2. Whether the Court of Appeals misapprehended or grossly misapplied the appropriate standard of judicial review in setting aside a rule promulgated by the Federal Energy Regulatory Commission under § 210 of PURPA setting a rate for utility purchases of electricity from qualifying alternate energy sources?

PARTIES TO THE PROCEEDING BELOW

Parties before the Court of Appeals in addition to Petitioner and Respondents named in the caption of this case were intervenors Occidental Geothermal, Inc., Elizabethtown Gas Company and Brooklyn Union Gas Company.

LIST OF PARENT COMPANIES, SUBSIDIARIES AND AFFILIATES

A listing of parent companies, subsidiaries and affiliates of Petitioner as required by Rule 28.1 of the Supreme Court Rules appears beginning at p. A-1 of Appendix A hereto.

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Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

Petitioner American Paper Institute, Inc. ("API"), intervenor in the proceeding below, respectfully prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the District of Columbia Circuit entered on January 22, 1982 vacating two rules issued by the Federal Energy Regulatory Commission.

OPINIONS BELOW

The opinion of the Court of Appeals is officially reported at 675 F.2d 1226, and is set forth in Appendix B hereto at p. B-1.[1] The order denying rehearing is officially reported at 675 F.2d 1226, 1246, and appears at B-202. The order denying rehearing *en banc*, and the dissenting statement of Circuit Judges Wald and Mikva are officially reported at 675 F.2d 1226, 1247, and are set forth at B-205.

Federal Energy Regulatory Commission ("FERC" or "the Commission") order No. 69, dated February 19, 1980, was published in the Federal Register at 45 Fed. Reg. 12,214 (1980). It appears at B-38. FERC order No. 70, dated March 13, 1980, was published at 45 Fed. Reg. 17,959 (1980), and is reprinted at B-120. The Commission's order of May 15, 1980, granting in part and denying in part rehearing of orders 69 and 70, and amending regulations, was published at 45 Fed. Reg. 33,958 (1980), and is set forth at B-175.

JURISDICTION

The Judgment of the Court of Appeals was entered on January 22, 1982 (B-200). Rehearing and suggestion for rehearing *en banc* were denied on April 9, 1982 (B-202, 205). This petition is filed within 90 days of the date of the denial of rehearing. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

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1 Citations to the Appendices to this Petition hereafter will refer only to the page number(s), e.g.: A-10, B-10.

STATUTORY AND REGULATORY PROVISIONS INVOLVED

This case involves the following statutory and regulatory provisions, set out verbatim beginning at the page number referred to:

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Public Utility Regulatory Policies Act of 1978:	
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STATEMENT OF THE CASE

This was a review, on the petition of three utilities, of rules regarding cogeneration and small power production which were promulgated by FERC to implement the requirements of §§ 201 and 210 of the Public Utility Regulatory Policies Act of 1978 ("PURPA"), Pub.L. No. 95-617, 92 Stat. 3117 (1978).[2]

Jurisdiction of the Court of Appeals was invoked under § 313(b) of the Federal Power Act, 16 U.S.C. § 825*l*(b), 49 Stat. 860.[3]

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2 PURPA § 201, which amended § 3 of the Federal Power Act ("FPA"), required the Commission to establish criteria under which cogeneration and small power production facilities could *qualify* for PURPA's benefits. 16 U.S.C. §§ 796(17)-(18). FERC's rules setting up the § 201 criteria were published in order No. 70, as amended, Docket RM79-54. Only one of the provisions of order No. 70—the so-called "fuel use" issue—was challenged. This rule, however, was upheld by the court below, and is not a subject of this petition.

PURPA § 210, on the other hand, was not an amendment to the FPA. It directs FERC to prescribe rules as the Commission determines necessary respecting the *relationship* between qualifying facilities and electric utilities, to "encourage cogeneration and small power production." 16 U.S.C. § 824a-3(a). All of the Commission's rules under § 210 were developed in Docket RM79-55 and published in order No. 69, as amended. Three of those provisions were reviewed along with the "fuel use" rule. One of the three—the "simultaneous purchase and sale" rule—was also upheld and is not, therefore, before this Court.

3 In API's memorandum in support of the Commission's petition for rehearing and suggestion for rehearing *en banc*, API pointed out that § 313(b) of the FPA did not grant the Court of Appeals jurisdiction to review FERC's order No. 69. That order was issued under the authority of § 210 of PURPA, which is not an amendment to the FPA. (*See* n.2, *supra*.) Nothing else in PURPA, API noted, grants jurisdiction to the Court of Appeals to review Commission orders under § 210. API suggested that under these circumstances, the court's assertion of pendent jurisdiction over order No. 69 was a novel and unwarranted extension of that doctrine. The Court of Appeals did not address the issue in denying rehearing.

On November 9, 1978, PURPA was signed into law as part of a comprehensive package of legislation designed to combat the nationwide energy crisis. Earlier this term this Court upheld the constitutionality of PURPA against a facial challenge. *FERC* v. *Mississippi*, (Docket 80-1749) __ U.S. __, 50 U.S.L.W. 4566 (June 1, 1982). As the Court there observed, § 210 of PURPA seeks to encourage the development of cogeneration and small power production facilities because Congress believed that increased use of these sources of electricity would conserve energy and reduce demand for traditional fossil fuels.[4] For example, a cogeneration facility requires about half as much fuel to produce electricity and useful heat as would be required to produce the two separately (B-3). Two problems, however, impeded the development of these non-traditional facilities. One was the reluctance of utilities to purchase their electricity and to sell them needed back-up power. The other was that the burden of state and federal regulation on such facilities discouraged their development (50 U.S.L.W. at 4568).

In order to overcome these problems, PURPA § 210(a) directed that within one year after PURPA became law, FERC was to prescribe such rules as it determined necessary to encourage cogeneration and small power production. Those rules were to be prescribed after consultation with state and federal regulatory agencies, and after public notice and hearings. 16 U.S.C. § 824a-3(a). The Commission rulemaking

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4 A "cogeneration facility" is one that produces both electric energy and steam or some other form of useful energy, such as heat. 16 U.S.C. § 796(18)(A). A "small power production facility" is one that has a production capacity of not more than 80 megawatts and uses biomass, waste or renewable resources (such as wind, water, or solar energy) to produce electric power. 16 U.S.C. § 796(17)(A).

By Public Law 96-294, 94 Stat. 770, which was signed into law on June 30, 1980, Congress added "geothermal resources" to the list of renewable resources in § 796(17) (A).

The statutes printed in Appendix A to this Petition are those in existence at the time the rules under PURPA § 210 were promulgated in February, 1980.

procedures and deliberations were among the most comprehensive it has ever undertaken.[5] The final rules, produced after developing a record of over 4,000 pages of written comments and recorded testimony, cover more than 14 pages in the Code of Federal Regulations, and address virtually every significant aspect of the relationship between qualifying facilities and utilities (B-104-19; B-167-74).

Only four of these rules were challenged in the Court of Appeals; the court vacated two of them. The "full avoided cost" rule was set aside because, the court stated, "FERC has not adequately justified its adoption of the full avoided cost standard" (B-9).[6] The Commission had articulated three bases

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5 *See* Brief for Respondent Federal Energy Regulatory Commission, in the proceeding below, D.C. Cir. Docket No. 80-1789, at p. 23.

6 PURPA § 210(a) directs the Commission to prescribe rules which require electric utilities to offer to purchase electric energy from qualifying facilities. Section 210(b) provides for rules that set a rate for such purchases, but "No such rule . . . shall provide for a rate which exceeds the incremental cost to the electric utility of alternative electric energy." The "incremental cost of alternative electric energy" is defined in § 210(d) as "the cost to the electric utility of the electric energy which, but for the purchase from such cogenerator or small power producer, such utility would generate or purchase from another source" (A-10).

Since under § 210(a), the rules had to be promulgated within one year after November 9, 1978, FERC could not set individual rates for each of the utilities in the Nation in case-by-case determinations. Instead, the Commission adopted a single rule applicable nationwide. The rule prescribes a rate for purchases of electricity from newly developed qualifying facilities equal to the purchasing utility's "full avoided cost." These costs are defined, consistent with PURPA § 210(d), as "the incremental costs to an electric utility of electric energy or capacity or both which, but for the purchase from the qualifying facility or qualifying facilities, such utility would generate itself or purchase from another source." 18 C.F.R. § 292.304(b)(2)-(4), and § 292.101(6) (A-22-23).

The rules specifically provide, however, that state regulatory agencies and non-regulated utilities can obtain a waiver from FERC of the requirement that utilities pay full avoided cost to new facilities. 18 C.F.R. § 292.403. (A-24). The rules thus permitted flexibility at the state level in implementing the full avoided cost standard.

and purposes for adopting that rule, but these were deemed by the court to be "inadequate" (B-10-11).

The Court also vacated FERC's "interconnection" rule, as inconsistent with the Federal Power Act ("FPA") because § 210(e)(3) of PURPA provided that no qualifying facility may be exempted from the provisions of §§ 210-212 of the FPA.[7] It dismissed the Commission's interpretation of the statutes as "wholly unconvincing" (B-24) and, although granting that the Commission's construction was "not inherently implausible," found it "counterintuitive and inconsistent with the statute's explicit provisions" (B-24-25).

The Court of Appeals denied the Commission's petition for rehearing and suggestion for rehearing *en banc* (B-205).[8] Two of the five judges voting on the *en banc* suggestion dissented.[9] They would have reheard the case "because of the importance of the issues to major new energy programs," and they expressed their "serious doubts" over the original panel's "resolution of those issues" (B-206).

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7 Since PURPA directed the Commission to promulgate rules requiring utilities to purchase from and sell to qualifying facilities, the interconnection rule facilitated such purchases and sales by requiring that "any electric utility shall make such interconnections with any qualifying facility as may be necessary to accomplish purchases or sales under [the rule]." 18 C.F.R. § 292.303(c)(1). (A-22).

8 API filed a brief in support of the Commission's petition for rehearing *en banc*. API is the trade association of the pulp, paper and paperboard industry in the United States. This industry is the Nation's leader in the self-generation and cogeneration of electric power, and accounts for over 40 percent of all cogeneration in the United States today. As an industry it is also the Nation's third largest *purchaser* of electricity from electric utilities.

9 Circuit Judges Wright, Tamm, MacKinnon, Robb, Edwards and Bork did not participate in the *en banc* order (B-206).

REASONS FOR GRANTING THE WRIT

THIS CASE PRESENTS IMPORTANT QUESTIONS OF FEDERAL LAW AND NATIONAL ENERGY POLICY.

This case brings to the Court, for the first time, questions concerning the implementation of PURPA § 210. If allowed to stand, the decision below vacating two of the most crucial rules in the Commission's implementation program will have significant, adverse impacts upon national energy policy and will frustrate the express intent of Congress in enacting PURPA § 210. In setting aside the two rules, the court below disregarded applicable decisions of this Court, and grossly misapplied appropriate standards of judicial review.

A. The Decision Vacating The Commission's Interconnection Rule Will Substantially Frustrate Implementation Of The Important National Policy Expressed in § 210 Of PURPA.

As Congress was aware, a primary obstacle to the development of cogeneration and small power production facilities is the unwillingness of many utilities to purchase the power generated by such facilities, or to sell them the backup power they require (*see* B-4). PURPA § 210 was aimed specifically at removing this obstacle by directing FERC to issue rules requiring utilities to offer to purchase electricity from and sell it to qualifying facilities. Of course, no purchase or sale can take place unless a qualifying facility is connected to the utility's system. The statute is impotent, therefore, unless qualifying facilities have, or can promptly secure, such interconnection.

FERC issued a rule which assured such interconnection by requiring utilities to interconnect "with any qualifying facility as may be necessary to accomplish purchases or sales . . . " 18 C.F.R. § 292.303(c)(1). The Commission did so in order to guarantee qualifying facilities the benefits Congress intended to confer upon them, and thereby to encourage development of cogeneration and small power production as directed by

§ 210 of PURPA (B-179-80). The Commission's rules leave unimpaired the states' traditional role in assuring the safety and reliability of their utilities' systems (B-115-19).

The Court of Appeals struck down the interconnection rule because in its view PURPA § 210(e)(3) prohibited FERC from exempting qualifying facilities from the substantive and procedural requirements of FPA §§ 210 and 212, 16 U.S.C. §§ 824i and 824k.[10] Thus, rather than relieving potential qualifying facilities of the burden of state and federal regulation as Congress intended, the Court of Appeals' decision requires each qualifying facility, in order to obtain the right to interconnect, to meet the onerous substantive and procedural requirements—including an evidentiary hearing at the utility's option—of the Federal Power Act.[11]

The decision below eviscerates the intent of Congress and gives utilities a powerful tool with which they can return to the *status quo ante*. The application, notice, evidentiary hearing and proof requirements involved in case-by-case adjudication of interconnection applications under the FPA are susceptible of abuse by a recalcitrant utility. The possibility that a utility, experienced and resourceful in the ways of regulatory procedure and litigation, may force delays and multiply expenses by

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10 FPA §§ 210 and 212 were amendments to the Federal Power Act added by §§ 202 and 204 of PURPA.

11 Although the court suggested that such procedures may be "streamlined" (B-23), FPA § 210's unequivocal grant of the right to an "evidentiary hearing," 16 U.S.C. § 824i(b)(2), effectively negates the Commission's discretion to expedite procedures. An interconnection case was before FERC at the time the review below was in progress. *Central Power & Light Co., et al.*, Docket No. EL79-8. It had been in administrative pretrial proceedings for 2½ years at that point. *See* Brief for Respondent Federal Energy Regulatory Commission, D.C. Cir. Docket No. 80-1789, at p. 69, n.80. As the judges dissenting from the denial of rehearing *en banc* noted, the panel's suggestion of streamlined procedures was virtually meaningless since it "fails to explain how anything less than an evidentiary hearing would satisfy the requirements it imports from section 210 of the Federal Power Act, 16 U.S.C. § 824i." (B-208, n.3).

contesting an application for interconnection, will discourage many potential qualifying facilities from undertaking the risk and expense of development.

If it remains, therefore, the decision of the Court of Appeals will mean that most qualifying facilities will be able to sell to or purchase from a utility only if the utility is willing—precisely the situation which prevailed prior to PURPA. Hence, PURPA § 210's theoretical assurance of a market for sales of power will provide no practical benefit or encouragement.

Moreover, if the decision below is allowed to stand, its debilitating effects will not be limited to discouraging only the smaller projects. The largest private industrial companies will also forego investment in electric generation rather than disclose competitively sensitive information regarding capacity, planning or costs which would be divulged during the public hearing process required in FPA interconnection proceedings.[12] Furthermore, as a result of the decision below, utilities may abrogate or force renegotiation of existing contracts with qualifying facilities—contracts negotiated based upon the FERC regulations as promulgated two years prior to the decision of the Court of Appeals.[13]

Faced with these obstacles, many otherwise cost-effective and beneficial projects—even those now in the final stages of planning and financing—simply will not go forward. Such substantial adverse effects of the decision below are inconsistent with the national energy policy clearly enunciated by Congress in PURPA § 210, and, on this basis alone, warrant this Court's review.[14]

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12 The generation of electricity is not, of course, the primary business of such companies, and will not be pursued if the expense and effort are too burdensome.

13 Typically, such contracts authorize the utility to cancel or renegotiate if there is a materially adverse change in existing law.

14 As this Court observed in *FERC* v. *Mississippi, supra,* Congress determined that the development of such facilities would conserve

B. Setting Aside The Interconnection Rule Was An Unwarranted And Improper Departure By The Court Of Appeals From Doctrine Established By Applicable Decisions Of This Court

The rulemaking authority Congress gave to FERC was stated in the broadest terms in PURPA § 210: to prescribe "such rules as it [FERC] determines necessary to encourage cogeneration and small power production." 16 U.S.C. § 824a-3(a). The statute also unequivocally demands that those rules require utilities to offer to sell electricity to and purchase electricity from qualifying facilities.[15] In the face of this command, the Commission recognized the frustration of Congress' purpose that would result if utilities refused to interconnect with qualifying facilities and forced them to engage in lengthy interconnection proceedings under FPA §§ 210 and 212 (B-58). Accordingly, FERC interpreted PURPA's grant of authority to it either to order interconnection in specific instances (under FPA §§ 210 and 212) if a utility wanted to interconnect with a reluctant cogeneration or small power production facility, or to require interconnection by rule, if "necessary to encourage cogeneration and small power production" (under PURPA § 210), when a qualifying facility applied for such interconnection. (B-58-61; B-179-82).[16]

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energy, and, equally significantly, the "evidence before Congress showed the potential contribution of these sources of energy: it was estimated that if proper incentives were provided, industrial cogeneration alone could account for 7%-10% of the Nation's electrical generating capacity by 1987." (50 U.S.L.W. at 4570).

15 In light of the mandatory language of PURPA § 210(a)(1) and (2) that FERC "shall prescribe . . . rules" "which rules require electric utilities to offer to" sell to and purchase from qualifying facilities, no party challenged that aspect of the rules. The attack was more subtle.

16 This construction rationalized PURPA §§ 210(a) and 210(e)(3) by providing for full hearings when facilities were the *targets* of interconnection requests, while encouraging the development of such facilities when, as *applicants* for interconnection, they are assured a market for their electricity. This distinction, targets versus applicants, furthered

FERC's harmonious construction of these statutes was inherently reasonable. The court below, however, gave cavalier treatment to the Commission's interpretation, contrary to this Court's long-standing teaching that " 'the construction of a statute by those charged with its execution should be followed unless there are compelling indications that it is wrong' " (*N.Y. Dep't of Social Services* v. *Dublino*, 413 U.S. 405, 421 (1973) (citation omitted)).[17]

This doctrine carries particular weight where the agency is contemporaneously construing newly enacted legislation (*Power Reactor Development Co.* v. *International Union of Electrical, Radio and Machineworkers*, 367 U.S. 396, 408 (1961)):

> "Particularly is this respect due when the administrative practice at stake 'involves a contemporaneous construction of a statute by the men charged with the responsibility of setting its machinery in motion, of making the parts work efficiently and smoothly while they are yet untried and new' "[18] (citation omitted).

Even if the court below had an equally reasonable construction, its rejection of the interpretation given by FERC was antithetical to the doctrine enunciated by this Court in *Train* v. *Natural Resources Defense Council*, 421 U.S. 60, 87 (1975):

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the Congressional goal by encouraging facilities to qualify and promptly negotiate interconnection arrangements. The Court of Appeals rejected this harmonizing of the provisions of § 210 as "counterintuitive" and "inconsistent," while acknowledging that it was "not inherently implausible" (B-24-25).

17 *See also Udall* v. *Tallman*, 380 U.S. 1, 16 (1965) ("This Court shows great deference to the interpretation given the statute by the officers or agency charged with its administration").

18 *See also Unemployment Commission* v. *Aragon*, 329 U.S. 143, 153 (1946) ("To sustain the Commission's application of this statutory term, we need not find that its construction is the only reasonable one, or even that it is the result we would have reached had the question arisen in the first instance in judicial proceedings").

> "We therefore conclude that the Agency's interpretation of [separate provisions of the statute] was 'correct' to the extent that it can be said with complete assurance that any particular interpretation of a complex statute such as this is the 'correct' one. Given this conclusion, as well as the facts that the Agency is charged with administration of the Act, and that there has undoubtedly been reliance upon its interpretation by the States and other parties affected by the Act, we have no doubt whatever that its construction was sufficiently reasonable to preclude the Court of Appeals from substituting its judgment for that of the Agency."[19]

The decision below, however, has construed PURPA § 210(e) in a manner which *unreasonably* denies FERC the very power Congress so obviously sought to give it. By limiting FERC to "the literal meaning of the statutory sections," (B-23) the Court of Appeals' ruling necessarily imputes to Congress the contradictory intention to encourage cogeneration and small power production with one hand in §§ 210(a) and (e)(1), and to stifle it with the other in § 210(e)(3).

In adopting a construction of the statute premised on such an absurdity, the court below disregarded numerous decisions of this Court. *See Clark* v. *Uebersee Finanz-Korp.*, 332 U.S. 480, 489, (1947) (a literally exclusionary definition was construed as "merely illustrative," because "to do otherwise would be to impute to Congress a purpose to paralyze with one hand what it sought to promote with the other"); *Crown Simpson Pulp Co.* v. *Costle*, 445 U.S. 193, 196-97 (1980) ("absent a far clearer expression of congressional intent, we are unwilling to read the [Federal Water Pollution Control] Act as creating such a seemingly irrational . . . system"). Indeed, the judges

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19 *See also Fawcus Machine Co.* v. *United States*, 282 U.S. 375, 378 (1931) ("[the regulations] constitute contemporaneous construction by those charged with the administration of the Act, are for that reason entitled to respectful consideration, and will not be overruled except for weighty reasons").

dissenting from the 3-2 vote denying rehearing below were troubled precisely because of this incongruous construction of the statute (B-208):

> "The alternative interpretation is a plausible one and appears to be more closely in line with Congress' expressed desire to encourage cogeneration. This alternative reading should receive closer scrutiny by this court before it erects a formidable, perhaps insurmountable, roadblock to a major energy program."[20]

C. By Vacating The Full Avoided Cost Rule The Decision Below Will Cripple A Major Federal Energy Program

In setting aside the full avoided cost rule, the Court of Appeals created a critical gap in the comprehensive regulatory framework promulgated to implement PURPA. Owners of potential qualifying facilities, and prospective investors, are now without the basis necessary to estimate revenue streams for their projects. Moreover, without a mutually understood starting point for determining the maximum price a utility could be required to pay absent agreement, price negotiations between utilities and qualifying facilities will be unduly prolonged—a discouraging prospect at best for project developers.[21] Operators of facilities that must depend on project

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20 *See also Ozawa* v. *United States*, 260 U.S. 178, 194 (1922) (court will give statute "effect in accordance with its design and purpose, sacrificing, if necessary the literal meaning in order that the purpose may not fail"); *United States* v. *American Trucking Ass'n*, 310 U.S. 534, 543 (1940) (when statutory language produces results divergent from Congressional purpose, "this Court has followed that purpose, rather than the literal words").

21 Nothing in the rules precludes a utility from paying at a rate other than "avoided cost." What the rule assures is that a utility will pay "avoided cost" if the utility and qualifying facility cannot agree on some other mutually acceptable rate. As a practical matter, however, utilities retain such great leverage that most contracts which have been signed to date are at a rate below full avoided cost. Without full avoided cost as a starting point for negotiations, a hostile utility will easily be able to evade its obligation under PURPA § 210 to offer to purchase electricity.

financing, such as many small hydro-electric projects, are particularly sensitive to risk factors affecting cash flow. The delay while a new rule is promulgated, created by the Court of Appeals' holding, will compel large industrial companies to find other uses for their internally-generated investment capital.

Even qualifying facilities which are presently in place and selling power are in jeopardy because of the decision below. A qualifying facility selling power to a utility in accordance with the rules but without benefit of a contract, or pursuant to a contract cancellable in the event of a materially adverse change in the existing law—a not uncommon provision in regulated industries—is now in danger of peremptory cancellation of the arrangement, unless the facility accepts the utility's terms.

Ironically, if the holding below prevails, state regulatory agencies that have already implemented or wish to implement the program outlined by PURPA § 210 face substantial obstacles in attempting to repair the damage done to the FERC rules. Each state agency must now determine whether it is authorized to set *any* rates for utilities' purchases of power from qualifying facilities. This will require consideration whether its authorities and actions are constitutional under the Commerce Clause, or whether they may be preempted by the rate regulation provisions in Title II of the FPA. 16 U.S.C. §§ 824-824h. Even if a state agency finds that it has sufficient authority to establish rates for purchases, it still faces a considerable administrative burden in developing a record to support any particular rate.[22]

Inevitably these doubts and delays will have a substantial debilitating effect on the most significant aspect of the regulatory scheme contemplated by PURPA § 210—state agency

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22 Any revision of the full avoided cost rule will result in further delay while the states implement the revision pursuant to PURPA § 210(f)(1). 16 U.S.C. § 824a-3(f)(1). Many projects will not survive such a delay.

consideration and implementation.[23] Qualifying facility investors and developers will not be able to rely on state regulators as a relatively inexpensive, locally available enforcement option. Until the rate at which utilities can be required to purchase power from qualifying facilities is finally determined, state regulators will be unable to take action reasonably designed to give effect to FERC's rules. The uncertainty cast on this important federal program by the decision below makes this case, therefore, a particularly compelling one for review by this Court.

D. The Decision Vacating The Full Avoided Cost Rule Both Applied The Wrong Standard of Review And Improperly Substituted The Court's Judgment For That Of The Commission

The decision of the court below setting aside the Commission's full avoided cost rule will, if permitted to stand, signal a new and unfortunate intervention of the judiciary into the province of administrative rulemaking.[24] The opinion of the Court of Appeals undermines principles of judicial review established by this Court which attempt to maintain the separation of functions between the courts and administrative agencies. The decision below will inevitably inhibit informal rulemaking by agencies which employ that useful process. The potential harm of the decision is compounded because it issued from the Court of Appeals for the District of Columbia Circuit, in which perhaps the bulk of all agency appellate reviews are brought, and to which many other courts look for guidance on matters of administrative law.

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23 As this Court observed in *FERC* v. *Mississippi, supra*, the FERC regulations "afford state regulatory authorities and nonregulated utilities latitude in determining the manner in which the regulations are to be implemented." (50 U.S.L.W. at 4568.)

24 Unlike the interconnection rule, respondents did not challenge the Commission's authority to issue a rule setting a rate for the purchase of power by utilities. Their challenge, upheld by the court below, was to the wisdom of the rate set by FERC—the utility's full avoided cost.

As the dissenters from the denial of the petition for the rehearing *en banc* accurately noted, the panel below apparently assumed that the substantial evidence test governs review of rules promulgated under PURPA § 210 (B-207, n.2).

The court's application of the substantial evidence test to the avoided cost rule was apparently the result of an erroneous assumption—that the Court of Appeals had jurisdiction to review PURPA § 210 rules directly under § 313(b) of the FPA, which prescribes the substantial evidence test for review of Commission actions under the FPA. 16 U.S.C. § 825*l*(b). *See* n.3, *supra*. Even if the court below properly assumed pendent jurisdiction over review of the PURPA § 210 rules, however, the appropriate standard of review is *not* a matter of the court's discretion. The Administrative Procedure Act, not the FPA standard, applies to the court's review of the rules. Thus, the dissenters observed that (B-207, n.2):

> "PURPA, however, does not set forth a heightened standard of review. The avoided cost rule is therefore subject to the general requirements of the APA, and may be overturned if it is 'arbitrary, capricious, an abuse of discretion or otherwise not in accordance with law. 5 U.S.C. § 706(2)(A).' "[25]

Under the "arbitrary or capricious" standard, "[t]he court is not empowered to substitute its judgment for that of the agency." *Citizens to Preserve Overton Park* v. *Volpe*, 401 U.S. 402, 416 (1971). And while the agency must set out the reasons for its rules in a "concise general statement of [the rules'] basis and purpose," APA § 4(c), 5 U.S.C. § 553(c), it is not required thereby to provide detailed and comprehensive findings of fact. *Camp* v. *Pitts*, 411 U.S. 138, 143 (1973); *see also*

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25 The panel did not set aside the full avoided cost rule because it was "arbitrary, capricious, an abuse of discretion or otherwise not in accordance with law." Rather it disagreed with the reasons given by FERC when adopting the rule because, in the panel's view, they were "inadequate" (B-10-11). Thus, the panel both applied the wrong standard of review and substituted its views for that of the rulemaker.

Bowman Transportation, Inc. v. *Arkansas-Best Freight System, Inc.*, 419 U.S. 281, 290 (1974) ("we can discern in the Commission's opinion a rational basis for its treatment of the evidence, and the 'arbitrary and capricious' test does not require more").

Subjecting the Commission's rules to the wrong standard of review, the court then proceeded to misapply that standard and set aside the carefully considered rule establishing the rate at which utilities could be required to purchase power from qualifying facilities. It has long been settled, however, that "Courts are *without authority* to set aside *any* rate selected by the Commission which is within a 'zone of reasonableness.' " *Permian Basin Area Rate Cases*, 390 U.S. 747, 767 (1968) (emphasis added), quoting from *FPC* v. *Natural Gas Pipeline Co.*, 315 U.S. 575, 585 (1942).

The court below quoted from legislative history demonstrating that FERC's avoided cost rule was within the range of the "just and reasonable" rates Congress intended to authorize (B-9-10). Nevertheless it set the rule aside because it was at the upper bound of that range (B-11-12) on the stated basis that FERC's reasons for adopting the rule were "inadequate" (B-11). It then went substantially further, directing FERC on remand to consider numerous additional "concerns" which the court had and "to take a harder look" at the court's preferred rate (B-12).[26] In short, the court substituted its judgment of a reasonable rate for that of the Commission.

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26 The dissenters on the *en banc* question did not understand the need for any additional determinations by FERC (B-207):

> "The panel rejected the Commission's determination for failure to explain adequately how utility consumers' interests had been accommodated, specifically with respect to rejection of one particular alternative to fully avoided costs. As we read the Commission's opinion, however, it found that the appropriate balance of statutory interests had been struck in a rate that would encourage cogeneration without raising rates to consumers. This determination seems reasonable, and we doubt that any further explanation, especially in the way of factual findings, *see* at 1234, was necessary to satisfy the requirements of the Administrative Procedure Act, 5 U.S.C. § 706(2)(A)."

The panoply of conditions, factual investigations, findings, alternative considerations and detailed explanations required of FERC, if permitted to stand, will impose upon informal rulemakers a standard even more formidable than the one which prompted this Court's admonishment in *Vermont Yankee Nuclear Power Corp.* v. *NRDC*, 435 U.S. 519, 547-48 (1978):

> "If the agency is compelled to support the rule which it ultimately adopts with the type of record produced only after a full adjudicatory hearing, it simply will have no choice but to conduct a full adjudicatory hearing prior to promulgating every rule."

The instant case is an even more egregious judicial imposition than that in *Vermont Yankee* because the facts and evidence required by the court here were not quantifiable at the time the rules were issued. No one had the market experience necessary to develop the data which the Court of Appeals insisted be considered, even in a full adjudicatory hearing.[27] FERC's handicap was compounded by a statutory compulsion to issue rules within one year of the passage of the Act. PURPA § 210(a), 16 U.S.C. § 824a-3(a).[28]

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27 Indeed, the panel's criticism of FERC for not adopting a percentage of full avoided cost rate does not demonstrate a failing by FERC. Rather it seeks to give the utilities another opportunity to convince FERC that a lesser rate should apply. Thus, the panel stated (B-12):

> "FERC should allocate the benefits more evenly between the cogenerators and the utilities *if the utilities can demonstrate* that, under a percentage of avoided cost approach, an allocation less heavily favoring the cogenerators is in the public interest and the interest of the utilities' electric consumers, and will not disproportionately discourage cogeneration" (emphasis added).

Moreover, the court's "disproportionately discourage cogeneration" standard turns § 210 of PURPA on its head. As this Court observed in *FERC* v. *Mississippi, supra*, "Section 210 of PURPA . . . seeks to encourage the development of cogeneration and small power production facilities." (50 U.S.L.W. at 4568).

28 Unlike the court below, however, Congress and the Commission understood that this urgently-implemented program would need to be "from time-to-time, revise[d]". PURPA § 210(a), 16 U.S.C. 824a-3(a).

Finally, it is not clear that *any* explanation of the full avoided cost rule would have satisfied the panel below, since it appears that it was primarily FERC's *conclusion*, and not its failure to comply with proper standards of rulemaking, that displeased the court. Thus, when the panel rejected FERC's challenge to the standing of the petitioners below, it foretold the intended effect of its decision on the rule (B-7 at n.26):

> "If petitioners prevail before this court, *the rule will be changed* to permit the states *to allow the petitioners to purchase electricity at prices lower than those now required*" (emphasis added).

Hence, the court below, consciously or not, substituted its judgment for that of the agency charged by Congress with the proper administration of the statute. Such judicial activism is improper. *Citizens to Preserve Overton Park* v. *Volpe*, 401 U.S. 402, 416 (1971).

CONCLUSION

For the reasons set forth above, a writ of certiorari should issue to review the judgment of the Court of Appeals for the District of Columbia Circuit.

Respectfully submitted,

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July 8, 1982

Listing of Parent Companies, Subsidiaries and Affiliates of Petitioner

The American Paper Institute, Inc. is a non-profit national trade association of the pulp, paper and paperboard manufacturing industry, whose 164 member companies, and their divisions, subsidiaries and affiliates primarily engaged in the manufacture of pulp, paper and paperboard products are listed below. This list does not include (in the case of diversified member companies) divisions, subsidiaries or affiliates primarily engaged in other businesses.

Alabama River Pulp Company, Inc.
  Subsidiary of Parsons & Whittemore, Inc.
American Can Company
American Convenience Products, Inc.
Amricon Corporation
Appleton Papers, Inc.
  Subsidiary of B.A.T. Industries
Augusta Newsprint Company
Banner Fibreboard Company
Bay West Paper Company
Bear Island Paper Company
Bird & Son, Inc.
Blandin Paper Company
Boise Cascade Corporation
Bowater, Inc.
Brunswick Pulp & Paper Company
The Buckeye Cellulose Corporation
Burrows Paper Corporation
J.D. Cahill Company, Inc.
Caraustar Industries, Inc.
  Subsidiaries:
    Ashuelot Paper Company, Inc.,
    Austell Box Board Corporation,
    Carolina Paper Board Corporation,

Carotell Paper Board Corporation,
Sweetwater Paper Board Company.
Chicopee
Division of Johnson & Johnson
Champion International Corporation
The Chesapeake Corporation of Virginia
Cleaners Hanger Company
Clevepak Corporation
The Columbia Corporation
Consolidated Packaging Corporation
Consolidated Papers, Inc.
Container Corporation of America
Subsidiary of Mobil Corporation
The Continental Group, Inc., Continental
Forest Industries
Cottrell Paper Company, Inc.
CPM, Inc.
Crane & Company, Inc.
Crown Paper Board Company, Inc.
Crown Zellerbach Corporation
The Crystal Tissue Company
Deerfield Specialty Papers, Inc.
The Dexter Corporation
Diamond International Corporation
Domtar Fine Papers
Dunn Paper Company
Subsidiary of Dennison Mfg. Company
Eastern Fine Paper, Inc.
Division of E.B. Eddy Forest Products, Ltd.
Eastex Division Temple-Eastex, Inc.
Subsidiary of Time, Inc.
Ecusta Paper & Film Group Olin Corporation
Equitable Bag Company, Inc.
Erving Paper Mills
Esleek Manufacturing Company
Exton Paper Manufacturers, Inc.
Federal Paper Board Company, Inc.
Fibre Leather Manufacturing Corporation

Finch, Pruyn & Company, Inc.
Flambeau Paper Corporation
  Subsidiary of Pentair, Inc.
Fletcher Paper Company
Fortifiber Corporation
Foster Paper Company
Fox River Paper Company
  Division of Fox Valley Corp.
Fraser Paper, Limited
French Paper Company
FSC Paper Corporation
  Subsidiary of Field Enterprises, Inc. and Media General, Inc.
Garden State Paper Company, Inc.
  Affiliate of Media General, Inc.
Georgia-Pacific Corporation
Gilman Paper Company
P.H. Glatfelter Company
W.R. Grace & Company
Great Northern Nekoosa Corporation
Green Bay Packaging, Inc.
Greif Board Corporation
Gulf States Paper Corporation
Halltown Paperboard Company
Hammermill Paper Company
Hampden Papers, Inc.
Harriman Paperboard Company
Hazen Paper Company
Heller and Usdan, Inc.
Hercules Inc.
Hoffmaster Company, Inc.
Hollingsworth & Vose Company
Holliston Mills, Inc.
Holyoke Card & Paper Company
Inland Container Corporation
  Subsidiary of Time, Inc.
Inland Empire Paper Company
International Paper Company

ITT Rayonier, Inc.
James River Corporation of Virginia
Jen-Coat, Inc.
Keyes Fibre Company
Kieffer Paper Mills, Inc.
Lawrence Paperboard Corporation
Linweave, Inc.
Litton Industries, Inc.
Longview Fibre Company
Louisiana-Pacific Corporation
Lowe Paper Company
Ludlow Corporation
Lydall Inc.
MacMillan Bloedel, Inc.
Madison Paper Corporation
McIntyre Bros. Paper Company, Inc.
Manistique Pulp & Paper Company
  Subsidiary of Field Enterprises, Inc.
Manville Forest Products Corporation
  Subsidiary of Johns-Manville Corporation
Marcal Paper Mills, Inc.
The Mead Corporation
Menasha Corporation
Menominee Paper Co., Inc.
  Subsidiary of Bell Fibre Products Corporation
Merrimac Paper Company, Inc.
Midtec Paper Corporation
Millers Falls Paper Company
Missisquoi
Mohawk Paper Mills, Inc.
Monadnock Paper Mills, Inc.
Morris Paper Board Company
  Division of Berles Carton Company, Inc.
Mosinee Paper Corporation
National Gypsum Company
The Newark Group
  Subsidiaries:
    California Paperboard Corporation,

Connecticut Paperboard Corporation,
Haverhill Paperboard Corporation,
Middletown Paperboard Corporation,
Natick Paperboard Corporation,
Newark Boxboard Company,
Wisconsin Paperboard Corporation.

Newman & Company, Inc.
Newton Falls Paper Mill, Inc.
Nicolet Paper Company
Affiliate of Philip Morris, Inc.
Nitec Paper Company
Orchids Paper Products-Concel, Inc.
Subsidiary of APL Corporation
Owens-Illinois, Inc.
Packaging Corporation of America
Division of Tenneco, Inc.
Paper Art Company, Inc.
Paper Products, Inc.
Parsons Paper Division, The NVF Company
Pejepscot Paper Division, The Hearst Corporation
Penntech Papers, Inc.
Plainwell Paper Company, Inc.
Affiliate of Philip Morris, Inc.
Pope & Talbot, Inc.
Port Huron Paper Company
Potlatch Corporation
Potsdam Paper Company
The Procter & Gamble Company
The Quaker Oats Company
Riegel Textile Corporation
Rising Paper Company
Rock-Tenn Company
St. Joe Paper Company
St. Regis Paper Company
Scott Paper Company
Seaman Paper Company of Massachusetts, Inc.
Shawano Paper Mills
Simpson Paper Co.
Subsidiary of Simpson Timber Company

H.P. Smith Paper Company
Sonoco Products Company
The Sorg Paper Company
Southeast Paper Manufacturing Company
Southwest Forest Industries, Inc.
Southworth Company
Springprint Paper Products Co.
Stevens & Thompson Paper Company
Division of Dixico Inc.
Stirling Converting Company, Inc.
Stone Container Corporation
Sullivan Paper Company
Tagsons Papers, Inc.
The Tuttle Press Company
Division of Fox Valley Corporation
Union Camp Corporation
Virginia Fibre Corporation
West Carrollton Parchment Company
Willamette Industries, Inc.
Weston Paper and Manufacturing Company, Inc.
Byron Weston Company
Westvaco Corporation
Weyerhaeuser Company
Whitestone Products
Division of IPCO Hospital Supply Corporation
Wisconsin Tissue Mills, Inc.
Affiliate of Philip Morris, Inc.
Yorktowne Paper Mills, Inc.
Subsidiary: Yorktowne Paper Mills of Maine

STATUTORY AND REGULATORY PROVISIONS INVOLVED

Statutory Provisions

Section 201 of PURPA provides in pertinent part (16 U.S.C. § 796):

Section 3 of the Federal Power Act is amended by inserting the following before the period at the end thereof:

> "(17)(A) 'small power production facility' means a facility which—
>
> > "(i) produces electric energy solely by the use, as a primary energy source, of biomass, waste, renewable resources, or any combination thereof; and
> >
> > "(ii) has a power production capacity which, together with any other facilities located at the same site (as determined by the Commission), is not greater than 80 megawatts;
>
> • • •
>
> "(C) 'qualifying small power production facility' means a small power production facility—
>
> > "(i) which the Commission determines, by rule, meets such requirements (including requirements respecting fuel use, fuel efficiency, and reliability) as the Commission may, by rule, prescribe; and
> >
> > "(ii) which is owned by a person not primarily engaged in the generation or sale of electric power (other than electric power solely from cogeneration facilities or small power production facilities);
>
> "(D) 'qualifying small power producer' means the owner or operator of a qualifying small power production facility;

"(18)(A) 'cogeneration facility' means a facility which produces—

"(i) electric energy, and

"(ii) steam or forms of useful energy (such as heat) which are used for industrial, commercial, heating, or cooling purposes;

"(B) 'qualifying cogeneration facility' means a cogeneration facility which—

"(i) the Commission determines, by rule, meets such requirements (including requirements respecting minimum size, fuel use, and fuel efficiency) as the Commission may, by rule, prescribe; and

"(ii) is owned by a person not primarily engaged in the generation or sale of electric power (other than electric power solely from cogeneration facilities or small power production facilities);

"(C) 'qualifying cogenerator' means the owner or operator of a qualifying cogeneration facility;

• • •

"(20) 'evidentiary hearings' and 'evidentiary proceedings' mean a proceeding conducted as provided in sections 554, 556, and 557 of title 5, United States Code;

Section 210 of PURPA provides (16 U.S.C. § 824a-3):

Cogeneration and Small Power Production

(a) COGENERATION AND SMALL POWER PRODUCTION RULES.—Not later than 1 year after the date of enactment of this Act, the Commission shall prescribe, and from time to time thereafter revise, such rules as it determines necessary to encourage cogeneration and small power production which rules require electric utilities to offer to—

(1) sell electric energy to qualifying cogeneration facilities and qualifying small power production facilities and

(2) purchase electric energy from such facilities.

Such rules shall be prescribed, after consultation with representatives of Federal and State regulatory agencies having ratemaking authority for electric utilities, and after public notice and a reasonable opportunity for interested persons (including State and Federal agencies) to submit oral as well as written data, views, and arguments. Such rules shall include provisions respecting minimum reliability of qualifying cogeneration facilities and qualifying small power production facilities (including reliability of such facilities during emergencies) and rules respecting reliability of electric energy service to be available to such facilities from electric utilities during emergencies. Such rules may not authorize a qualifying cogeneration facility or qualifying small power production facility to make any sale for purposes other than resale.

(b) RATES FOR PURCHASES BY ELECTRIC UTILITIES.—The rules prescribed under subsection (a) shall insure that, in requiring any electric utility to offer to purchase electric energy from any qualifying cogeneration facility or qualifying small power production facility, the rates for such purchase—

(1) shall be just and reasonable to the electric consumers of the electric utility and in the public interest, and

(2) shall not discriminate against qualifying cogenerators or qualifying small power producers.

No such rule prescribed under subsection (a) shall provide for a rate which exceeds the incremental cost to the electric utility of alternative electric energy.

(c) RATES FOR SALES BY UTILITIES.—The rules prescribed under subsection (a) shall insure that, in requiring any electric utility to offer to sell electric energy to any qualifying cogeneration facility or qualifying small power production facility, the rates for such sale—

(1) shall be just and reasonable and in the public interest, and

(2) shall not discriminate against the qualifying cogenerators or qualifying small power producers.

(d) DEFINITION.—For purposes of this section, the term "incremental cost of alternative electric energy" means, with respect to electric energy purchased from a qualifying cogenerator or qualifying small power producer, the cost to the electric utility of the electric energy which, but for the purchase from such cogenerator or small power producer, such utility would generate or purchase from another source.

(e) EXEMPTIONS.—(1) Not later than 1 year after the date of enactment of this Act and from time to time thereafter, the Commission shall, after consultation with representatives of State regulatory authorities, electric utilities, owners of cogeneration facilities and owners of small power production facilities, and after public notice and a reasonable opportunity for interested persons (including State and Federal agencies) to submit oral as well as written data, views, and arguments, prescribe rules under which qualifying cogeneration facilities and qualifying small power production facilities are exempted in whole or part from the Federal Power Act, from the Public Utility Holding Company Act, from State laws and regulations respecting the rates, or respecting the financial or organizational regulation, of electric utilities, or from any combination of the foregoing, if the Commission determines such exemption is necessary to encourage cogeneration and small power production.

(2) No qualifying small power production facility which has a power production capacity which, together with any other facilities located at the same site (as determined by the Commission), exceeds 30 megawatts may be exempted under rules under paragraph (1) from any provision of law or regulation referred to in paragraph (1), except that any qualifying small power production facility which produces electric energy solely by the use of biomass as a primary energy source, may be

exempted by the Commission under such rules from the Public Utility Holding Company Act and from State laws and regulations referred to in such paragraph (1).

(3) No qualifying small power production facility or qualifying cogeneration facility may be exempted under this subsection from—

(A) any State law or regulation in effect in a State pursuant to subsection (f),

(B) the provisions of section 210, 211, or 212 of the Federal Power Act or the necessary authorities for enforcement of any such provision under the Federal Power Act, or

(C) any license or permit requirement under part I of the Federal Power Act, any provision under such Act related to such a license or permit requirement, or the necessary authorities for enforcement of any such requirement.

(f) IMPLEMENTATION OF RULES FOR QUALIFYING COGENERATION AND QUALIFYING SMALL POWER PRODUCTION FACILITIES.—(1) Beginning on or before the date one year after any rule is prescribed by the Commission under subsection (a) or revised under such subsection, each State regulatory authority shall, after notice and opportunity for public hearing, implement such rule (or revised rule) for each electric utility for which it has ratemaking authority.

(2) Beginning on or before the date one year after any rule is prescribed by the Commission under subsection (a) or revised under such subsection, each nonregulated electric utility shall, after notice and opportunity for public hearing, implement such rule (or revised rule).

(g) JUDICIAL REVIEW AND ENFORCEMENT.—(1) Judicial review may be obtained respecting any proceeding conducted by a State regulatory authority or nonregulated electric utility for purposes of implementing any requirement of a rule under subsection (a) in the same manner, and under the same require-

ments, as judicial review may be obtained under section 123 in the case of a proceeding to which section 123 applies.

(2) Any person (including the Secretary) may bring an action against any electric utility, qualifying small power producer, or qualifying cogenerator to enforce any requirement established by a State regulatory authority or nonregulated electric utility pursuant to subsection (f). Any such action shall be brought only in the manner, and under the requirements, as provided under section 123 with respect to an action to which section 123 applies.

(h) COMMISSION ENFORCEMENT.—(1) For purposes of enforcement of any rule prescribed by the Commission under subsection (a) with respect to any operations of an electric utility, a qualifying cogeneration facility or a qualifying small power production facility which are subject to the jurisdiction of the Commission under part II of the Federal Power Act, such rule shall be treated as a rule under the Federal Power Act. Nothing in subsection (g) shall apply to so much of the operations of an electric utility, a qualifying cogeneration facility or a qualifying small power production facility as are subject to the jurisdiction of the Commission under part II of the Federal Power Act.

(2)(A) The Commission may enforce the requirements of subsection (f) against any State regulatory authority or nonregulated electric utility. For purposes of any such enforcement, the requirements of subsection (f)(1) shall be treated as a rule enforceable under the Federal Power Act. For purposes of any such action, a State regulatory authority or nonregulated electric utility shall be treated as a person within the meaning of the Federal Power Act. No enforcement action may be brought by the Commission under this section other than—

(i) an action against the State regulatory authority or nonregulated electric utility for failure to comply with the requirements of subsection (f) or

(ii) an action under paragraph (1).

(B) Any electric utility, qualifying cogenerator, or qualifying small power producer may petition the Commission to enforce the requirements of subsection (f) as provided in subparagraph (A) of this paragraph. If the Commission does not initiate an enforcement action under subparagraph (A) against a State regulatory authority or nonregulated electric utility within 60 days following the date on which a petition is filed under this subparagraph with respect to such authority, the petitioner may bring an action in the appropriate United States district court to require such State regulatory authority or nonregulated electric utility to comply with such requirements, and such court may issue such injunctive or other relief as may be appropriate. The Commission may intervene as a matter of right in any such action.

(i) FEDERAL CONTRACTS.—No contract between a Federal agency and any electric utility for the sale of electric energy by such Federal agency for resale which is entered into after the date of the enactment of this Act may contain any provision which will have the effect of preventing the implementation of any rule under this section with respect to such utility. Any provision in any such contract which has such effect shall be null and void.

(j) DEFINITIONS.—For purposes of this section, the terms "small power production facility," "qualifying small power production facility," "qualifying small power producer," "primary energy source," "cogeneration facility," "qualifying cogeneration facility," and "qualifying cogenerator" have the respective meanings provided for such terms under section 3 (17) and (18) of the Federal Power Act.

Section 210 of the Federal Power Act provides (16 U.S.C. § 824i):

Interconnection authority—Powers of Commission; application by state regulatory authority

(a)(1) Upon application of any electric utility, Federal power marketing agency, geothermal power producer (including a producer which is not an electric utility), qualifying cogenerator, or qualifying small power producer, the Commission may issue an order requiring—

(A) the physical connection of any cogeneration facility, any small power production facility, or the transmission facilities of any electric utility, with the facilities of such applicant,

(B) such action as may be necessary to make effective any physical connection described in subparagraph (A), which physical connection is ineffective for any reason, such as inadequate size, poor maintenance, or physical unreliability,

(C) such sale or exchange of electric energy or other coordination, as may be necessary to carry out the purposes of any order under subparagraph (A) or (B), or

(D) such increase in transmission capacity as may be necessary to carry out the purposes of any order under subparagraph (A) or (B).

(2) Any State regulatory authority may apply to the Commission for an order for any action referred to in subparagraph (A), (B), (C), or (D) of paragraph (1). No such order may be issued by the Commission with respect to a Federal power marketing agency upon application of a State regulatory authority.

Notice, hearing and determination by Commission

(b) Upon receipt of an application under subsection (a) of this section, the Commission shall—

(1) issue notice to each affected State regulatory authority, each affected electric utility, each affected Federal power marketing agency, each affected owner or operator of a cogeneration facility or of a small power production facility, and to the public.

(2) afford an opportunity for an evidentiary hearing, and

(3) make a determination with respect to the matters referred to in subsection (c) of this section.

Necessary findings

(c) No order may be issued by the Commission under subsection (a) of this section unless the Commission determines that such order—

(1) is in the public interest,

(2) would—

(A) encourage overall conservation of energy or capital,

(B) optimize the efficiency of use of facilities and resources, or

(C) improve the reliability of any electric utility system or Federal power marketing agency to which the order applies, and

(3) meets the requirements of section 824k of this title.

Motion of Commission

(d) The Commission may, on its own motion, after compliance with the requirements of paragraphs (1) and (2) of subsection (b) of this section, issue an order requiring any action described in subsection (a)(1) of this section if the Commission determines that such order meets the requirements of subsection (c) of this section. No such order may be issued upon the Commission's own motion with respect to a Federal power marketing agency.

Definitions

(e)(1) As used in this section, the term "facilities" means only facilities used for the generation or transmission of electric energy.

(2) With respect to an order issued pursuant to an application of a qualifying cogenerator or qualifying small power producer under subsection (a)(1) of this section, the term "facilities of such applicant" means the qualifying cogeneration facilities or qualifying small power production facilities of the applicant, as specified in the application. With respect to an order issued pursuant to an application under subsection (a)(2) of this section, the term "facilities of such applicant" means the qualifying cogeneration facilities, qualifying small power production facilities, or the transmission facilities of an electric utility, as specified in the application. With respect to an order issued by the Commission on its own motion under subsection (d) of this section, such term means the qualifying cogeneration facilities, qualifying small power production facilities, or the transmission facilities of an electric utility, as specified in the proposed order.

Section 212 of the Federal Power Act provides in pertinent part (16 U.S.C. § 824k):

Orders requiring interconnection or wheeling—Determinations by Commission

(a) No order may be issued by the Commission under section 824i or subsection (a) or (b) of section 824j of this title unless the Commission determines that such order—

(1) is not likely to result in a reasonably ascertainable uncompensated economic loss for any electric utility, qualifying cogenerator, or qualifying small power producer, as the case may be, affected by the order;

(2) will not place an undue burden on an electric utility, qualifying cogenerator, or qualifying small power producer, as the case may be, affected by the order;

(3) will not unreasonably impair the reliability of any electric utility affected by the order; and

(4) will not impair the ability of any electric utility affected by the order to render adequate service to its customers.

The determination under paragraph (1) shall be based upon a showing of the parties. The Commission shall have no authority under section 824i or 824j of this title to compel the enlargement of generating facilities.

Reimbursement of parties subject to orders

(b) No order may be issued under section 824i or subsection (a) or (b) of section 824j of this title unless the applicant for such order demonstrates that he is ready, willing, and able to reimburse the party subject to such order for—

(1) in the case of an order under section 824i of this title, such party's share of the reasonably anticipated costs incurred under such order, and

(2) in the case of an order under subsection (a) or (b) of section 824j of this title—

(A) the reasonable costs of transmission services, including the costs of any enlargement of transmission facilities, and

(B) a reasonable rate of return on such costs, as appropriate, as determined by the Commission.

Issuance of proposed order; agreement by parties to terms and conditions of order; approval by Commission; inclusion in final order; failure to agree

(c)(1) Before issuing an order under section 824i or subsection (a) or (b) of section 824j of this title, the Commission shall issue a proposed order and set a reasonable time for parties to the proposed interconnection or transmission order to agree to

terms and conditions under which such order is to be carried out, including the apportionment of costs between them and the compensation or reimbursement reasonably due to any of them. Such proposed order shall not be reviewable or enforceable in any court. The time set for such parties to agree to such terms and conditions may be shortened if the Commission determines that delay would jeopardize the attainment of the purposes of any proposed order. Any terms and conditions agreed to by the parties shall be subject to the approval of the Commission.

(2)(A) If the parties agree as provided in paragraph (1) within the time set by the Commission and the Commission approves such agreement, the terms and conditions shall be included in the final order. In the case of an order under section 824i of this title, if the parties fail to agree within the time set by the Commission or if the Commission does not approve any such agreement, the Commission shall prescribe such terms and conditions and include such terms and conditions in the final order.

(B) In the case of any order applied for under section 824j of this title, if the parties fail to agree within the time set by the Commission, the Commission shall prescribe such terms and conditions in the final order.

Statement of reasons for denial

(d) If the Commission does not issue any order applied for under section 824i or 824j or this title, the Commission shall, by order, deny such application and state the reasons for such denial.

Utilization of interconnection or wheeling authority in lieu of other authority; limitation of Commission authority

(e) No provision of section 824i or 824j of this title shall be treated—

(1) as requiring any person to utilize the authority of such section 824i or 824j of this title in lieu of any other authority of law, or

(2) as limiting, impairing, or otherwise affecting any authority of the Commission under any other provision of law.

Section 313(b) of the Federal Power Act provides (49 Stat. 860, 16 U.S.C. § 825*l*(b)):

Rehearings; court review of orders

(b) Any party to a proceeding under this Act[*] aggrieved by an order issued by the Commission in such proceeding may obtain a review of such order in the United States Court of Appeals for any circuit wherein the licensee or public utility to which the order relates is located or has its principal place of business, or in the United States Court of Appeals for the District of Columbia, by filing in such court, within sixty days after the order of the Commission upon the application for rehearing, a written petition praying that the order of the Commission be modified or set aside in whole or in part. A copy of such petition shall forthwith be transmitted by the clerk of the court to any member of the Commission and thereupon the Commission shall file with the court the record upon which the order complained of was entered, as provided in section 2112 of Title 28. Upon the filing of such petition such court shall have jurisdiction, which upon the filing of the record with it shall be exclusive, to affirm, modify, or set aside such order in whole or in part. No objection to the order of the Commission shall be considered by the court unless such objection shall have been urged before the Commission in the application for rehearing unless there is reasonable ground for failure so to do. The finding of the Commission as to the facts,

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* In the U.S. Code, "this Act", meaning the Federal Power Act, has been replaced by "this chapter." Title 16 of the U.S. Code has not been enacted into law, however, so the language of FPA § 313 as it appears above, and at 49 Stat. 860, is the official wording of the statute.

if supported by substantial evidence, shall be conclusive. If any party shall apply to the court for leave to adduce additional evidence, and shall show to the satisfaction of the court that such additional evidence is material and that there were reasonable grounds for failure to adduce such evidence in the proceedings before the Commission, the court may order such additional evidence to be taken before the Commission and to be adduced upon the hearing in such manner and upon such terms and conditions as to the court may seem proper. The Commission may modify its findings as to the facts by reason of the additional evidence so taken, and it shall file with the court such modified or new findings which, if supported by substantial evidence, shall be conclusive, and its recommendation, if any, for the modification or setting aside of the original order. The judgment and decree of the court, affirming, modifying, or setting aside, in whole or in part, any such order of the Commission, shall be final, subject to review by the Supreme Court of the United States upon certiorari or certification as provided in sections 346 and 347 of Title 28.

Section 4(c) of the Administrative Procedure Act provides (5 U.S.C. § 553(c)):

(c) After notice required by this section, the agency shall give interested persons an opportunity to participate in the rule making through submission of written data, views, or arguments with or without opportunity for oral presentation. After consideration of the relevant matter presented, the agency shall incorporate in the rules adopted a concise general statement of their basis and purpose. When rules are required by statute to be made on the record after opportunity for an agency hearing, sections 556 and 557 of this title apply instead of this subsection.

Section 10(b) of the Administrative Procedure Act provides in pertinent part (5 U.S.C. § 703):

Form and venue of proceeding

The form of proceeding for judicial review is the special statutory review proceeding relevant to the subject matter in a court specified by statute or, in the absence or inadequacy thereof, any applicable form of legal action, including actions for declaratory judgments or writs of prohibitory or mandatory injunction or habeas corpus, in a court of competent jurisdiction.

Section 10(e) of the Administrative Procedure Act provides in pertinent part (5 U.S.C. § 706):

Scope of review

To the extent necessary to decision and when presented, the reviewing court shall decide all relevant questions of law, interpret constitutional and statutory provisions, and determine the meaning or applicability of the terms of an agency action. The reviewing court shall—

* * *

(2) hold unlawful and set aside agency action, findings, and conclusions found to be—

(A) arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law.

Regulatory Provisions

The Federal Energy Regulatory Commission's "interconnection" rule provides (18 C.F.R. § 292.303(c)(1)):

(c) *Obligation to interconnect.* (1) Subject to paragraph (c)(2) of this section, any electric utility shall make such interconnections with any qualifying facility as may be necessary to accomplish purchases or sales under this subpart.

The Federal Energy Regulatory Commission's "full avoided cost" rule provides (18 C.F.R. §§ 292.304(b)(2)-(4)):

Rates for purchases.[*]

(a) *Rates for purchases.* (1) Rates for purchases shall:

(i) Be just and reasonable to the electric consumer of the electric utility and in the public interest; and

(ii) Not discriminate against qualifying cogeneration and small power production facilities.

(2) Nothing in this subpart requires any electric utility to pay more than the avoided costs for purchases.

(b) *Relationship to avoided costs.* (1) For purposes of this paragraph, "new capacity" means any purchase from capacity of a qualifying facility, construction of which was commenced on or after November 9, 1978.

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* For the convenience of the Court, §§ 292.304(a) through (b)(1) are included for reference.

(2) Subject to paragraph (b)(3) of this section, a rate for purchases satisfies the requirements of paragraph (a) of this section if the rate equals the avoided costs determined after consideration of the factors set forth in paragraph (e) of this section.

(3) A rate for purchases (other than from new capacity) may be less than the avoided cost if the State regulatory authority (with respect to any electric utility over which it has rate-making authority) or the nonregulated electric utility determines that a lower rate is consistent with paragraph (a) of this section, and is sufficient to encourage cogeneration and small power production.

(4) Rates for purchases from new capacity shall be in accordance with paragraph (b)(2) of this section, regardless of whether the electric utility making such purchases is simultaneously making sales to the qualifying facility.

The Federal Energy Regulatory Commission's definition of "avoided cost" states (18 C.F.R. § 292.101(6)):

"Avoided costs" means the incremental costs to an electric utility of electric energy or capacity or both which, but for the purchase from the qualifying facility or qualifying facilities, such utility would generate itself or purchase from another source.

The Federal Energy Regulatory Commission's waiver provisions provide (18 C.F.R. § 292.403):

(a) *State regulatory authority and nonregulated electric utility waivers.* Any State regulatory authority (with respect to any electric utility over which it has ratemaking authority) or nonregulated electric utility may, after public notice in the area served by the electric utility, apply for a waiver from the application of any of the requirements of Subpart C [§§ 292.301-.308] (other than § 292.302 thereof).

(b) *Commission action.* The Commission will grant such a waiver only if an applicant under paragraph (a) of this section demonstrates that compliance with any of the requirements of Subpart C is not necessary to encourage cogeneration and small power production and is not otherwise required under section 210 of PURPA.

82-34

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JUL 8 1982
ALEXANDER L. STEVAS,
CLERK

No. __

IN THE

Supreme Court of the United States

OCTOBER TERM, 1981

AMERICAN PAPER INSTITUTE, INC.,

Petitioner,

—v.—

AMERICAN ELECTRIC POWER SERVICE CORPORATION, CONSOLIDATED EDISON COMPANY OF NEW YORK, INC., COLORADO-UTE ELECTRIC ASSOCIATION, INC., FEDERAL ENERGY REGULATORY COMMISSION, *et al.*,

Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

APPENDIX B

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UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

No. 80-1789

AMERICAN ELECTRIC POWER SERVICE CORPORATION, et al.,
Petitioners,

—v.—

FEDERAL ENERGY REGULATORY COMMISSION,
Respondent,

ELIZABETHTOWN GAS COMPANY,
AMERICAN PAPER INSTITUTE, INC.,
BROOKLYN UNION GAS CO.,
OCCIDENTAL GEOTHERMAL, INC.,
Intervenors.

Petition for Review of Orders of the
Federal Energy Regulatory Commission

Argued 15 September 1981

Decided 22 January 1982

Edward Berlin with whom *Roger Strelow, Thomas M. Lemberg* and *Robert S. Taylor* were on the brief for petitioners.

John A. Cameron, Jr., Attorney, Federal Energy Regulatory Commission, with whom *Jerome Nelson*, Acting General

Counsel, *Jerome M. Feit,* Deputy Solicitor, *A. Karen Hill* and *Glenn J. Berger,* Attorneys, Federal Energy Regulatory Commission, were on the brief for respondent.

John T. Miller, Jr. was on the brief for intervenor, Elizabethtown Gas Company.

Rigdon H. Boykin was on the brief for intervenor, American Paper Institute, Inc.

James E. Rogers, Jr. and *Jeffrey D. Watkiss* were on the brief for intervenor, Occidental Geothermal, Inc.

James Patrick Slattery entered an appearance for intervenor, Brooklyn Union Gas Company.

Kathryn A. Oberly and *Susan V. Cook,* Attorneys, United States Department of Justice, were on the brief for amicus curiae, United States, urging that the Commission's order be upheld.

Robert H. Loeffler, Alan Cope Johnston and *Henry D. Levine* were on the brief for amici curiae, Great Western Malting Company, et al. urging that the Commission's order be upheld.

Philip R. Mann was on the brief for amicus curiae, California Manufacturers Association, urging denial of the petition for review.

Before: ROBINSON, *Chief Judge,* WILKEY and GINSBURG, *Circuit Judges.*

Opinion for the Court filed by *Circuit Judge* WILKEY.

WILKEY, *Circuit Judge:* This appeal involves those provisions of the Public Utility Regulatory Policies Act of 1978 (PURPA) which deal with cogeneration and small power production,[1] and the rules promulgated by the Federal Regulatory Energy Commission ("FERC" or "Commission") to imple-

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1 16 U.S.C. §§ 796(17)-(18), 824a-3, 824i, 824k (Supp. III 1979).

ment these provisions.[2] Petitioners, who are public utilities, challenge FERC on four specific issues. They are: (1) FERC's "full avoided cost" rule; (2) FERC's "simultaneous transaction" rule; (3) FERC's grant of blanket authority to cogenerators to "interconnect" with electric utilities without meeting the requirements of sections 210[3] and 212[4] of the Federal Power Act; and (4) FERC's failure to adopt "fuel use" criteria in determining what cogeneration facilities are "qualifying" facilities eligible for the benefits of PURPA.

We uphold FERC's actions with respect to the simultaneous transaction rule and fuel use. However, we find for the petitioners on the matters of the full avoided cost rule and interconnection, and vacate FERC's rules there.

I. BACKGROUND

Cogeneration is the combined production of electrical power and useful thermal energy, such as heat or steam. Cogeneration usually refers to the use of heat that would otherwise be wasted after electricity is generated ("topping cycle"); the term also applies to systems that generate electricity from heat left over from an industrial process ("bottoming cycle"). Because both heat and electricity are created in a single process, about half as much fuel is used to produce electricity and heat as would be needed to produce the two separately. While cogeneration is not a new concept, its popularity had declined steadily since the turn of the century as energy from central station power plants became relatively inexpensive. With the rise in utility rates in recent years, however, it became apparent that cogeneration might again become economical on a broad scale.[5]

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2 18 C.F.R. §§ 292.101-.602 (1980).

3 16 U.S.C. § 824i (Supp. III 1979).

4 *Id.* § 824k.

5 *See generally* COMPTROLLER GENERAL, U.S. GENERAL ACCOUNTING OFFICE, INDUSTRIAL COGENERATION—WHAT IT IS, HOW IT WORKS, ITS POTENTIAL (1980).

Small power production facilities, on the other hand, for the purposes of this case are those which use biomass, waste, geothermal resources, or renewable resources (including wind, solar energy, and water) to produce electric power. They may have a power production capacity no greater than 80 megawatts.[6]

The cogeneration and small power production provisions of PURPA were one part of a vast complex of five major statutes enacted in 1978, known jointly as the National Energy Act.[7] The provisions sought to encourage both sources of energy production.

Prior to the enactment of PURPA, a cogenerator or small power producer seeking to establish interconnected operation with a utility faced three major obstacles. First, utilities were often unwilling to purchase the other producers' electric output at all or were unwilling to pay an appropriate rate. Second, some utilities charged discriminatorily high rates for backup service to cogenerators and small power producers. Third, a cogenerator or small power producer which provided electricity to a utility ran the risk of being considered a public utility and subjected to extensive state and federal regulations.[8]

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6 16 U.S.C. § 796(17)(A) (Supp. III 1979). *See also* FEDERAL ENERGY REGULATORY COMM'N, DRAFT ENVIRONMENTAL IMPACT STATEMENT: RULEMAKING FOR: SMALL POWER PRODUCTION AND COGENERATION FACILITIES—QUALIFYING STATUS/RATES AND EXEMPTIONS, DOCKET NOS. RM79-54 & RM79-55 (June 1980).

7 The five statutes were PURPA, Pub. L. No. 95-617, 92 Stat. 3117 (1978); National Energy Conservation Policy Act, Pub. L. No. 95-619, 92 Stat. 3206 (1978); Natural Gas Policy Act, Pub. L. No. 95-621, 92 Stat. 3350 (1978); Energy Tax Act, Pub. L. No. 95-618, 92 Stat. 3174 (1978); Powerplant and Industrial Fuel Use Act (hereinafter "Fuel Use Act"), Pub. L. No. 95-620, 92 Stat. 3289 (1978).

8 *See, e.g.*, 123 CONG. REC. 32403 (5 Oct. 1977) (remarks of Sen. Durkin); *id.* at 32419 (remarks of Sen. Hart); *id.* at 32437 (remarks of Sen. Haskell); CONFERENCE REPORT ON THE PUBLIC UTILITY REGULATORY POLICIES ACT, H.R. REP. NO. 1750, 95th Cong., 2d Sess. (1978); EXECUTIVE OFFICE OF THE PRESIDENT, THE NATIONAL ENERGY PLAN 45 (G.P.O. 1977); COMMONWEALTH OF MASSACHUSETTS, COGENERATION: ITS BENEFITS TO NEW ENGLAND (October 1978).

Congress[9] designed section 210 of PURPA[10] to remove these institutional barriers to the development of small power production and cogeneration. Under section 210, each electric utility is required to offer to purchase available electric energy from cogeneration and small power production facilities which obtain qualifying status under section 201[11]; the utility is also obliged to provide backup power and other services to such facilities on a nondiscriminatory basis. Section 210 further directs the Commission to "prescribe, and from time to time thereafter revise, such rules as it determines necessary to encourage cogeneration and small power production . . . ."[12] These rules are to implement the statutory requirement that electric utilities offer to sell electric energy to cogeneration and small power production facilities and to purchase electric energy generated at these facilities. Qualifying small power producers and qualifying cogeneration facilities may be exempted in whole or part by Commission rule from the Federal Power Act, the Public Utility Holding Company Act,[13] and

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9 *See* congressional sources cited note 8 *supra*.

10 16 U.S.C. § 824a-3 (Supp. III 1979).

11 Section 201 of PURPA defines a *small power production facility* as one which "produces electric energy solely by the use, as primary energy source, of biomass, waste, renewable resources, or any combination thereof," with a power production capacity not greater than 80 megawatts. *Id.* § 796(17)(A). A small power producer must use a specified "primary energy source" for all energy generation, except as required for emergency, maintenance, or quality control purposes. *Id.* § 796(17)(B).

Section 201 next defines a *cogeneration facility* as a producer of "(i) electric energy, and (ii) steam or forms of useful energy (such as heat) which are used for industrial, commercial, heating, or cooling purposes . . . ." *Id.* § 796(18)(A). Unlike the provisions governing small power producers, the statute does not specify maximum size or "primary energy source" limitations for the cogenerators. However, in order to qualify, a person "not primarily engaged in the generation or sale of electric power" must satisfy such requirements governing minimum size, fuel use, and fuel efficiency "as the Commission may, by rule, prescribe . . . ." *Id.* § 796(18)(B).

12 *Id.* § 824a-3(a).

13 *Id.* §§ 79 to 79-6.

state laws and regulations respecting rates and the financial or organizational regulation of electric utilities, if the Commission determines such exemption is necessary to encourage cogeneration and small power production.[14]

After giving notice and soliciting comments FERC issued its rules regarding cogeneration rates and exemptions on 19 February 1980.[15] On 15 March 1980 it issued its rules with respect to what cogenerators would be considered "qualifying facilities."[16] Petitioners challenge four facets of these rules.

First, FERC would order the states to set rates for purchases of power from qualifying cogenerators at a level that always (for facilities built after the enactment of the statute) equals the utilities' full "avoided" cost.[17] "Avoided" cost refers to the incremental cost the utility would bear if it were required itself to supply the electricity produced by the cogenerator.[18]

Second, FERC would require utilities, at the cogenerator's option, to engage in a "simultaneous purchase and sale" by which the utility is deemed to have purchased all the cogenerated power, even that used by the cogenerator for itself, and to have sold to the cogenerator the power the cogenerator uses internally.[19]

Third, the Commission by rule[20] made a blanket grant of authority to cogenerators to interconnect with utilities without meeting the substantive and procedural requirements of the

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14 *Id.* § 824a-3(e).
Hereinafter in this opinion all references to cogenerators will also apply, unless otherwise stated, to small power producers.

15 18 C.F.R. §§ 292.101, .301-.602 (1980) (Order No. 69).

16 *Id.* §§ 292.201-.207 (Order No. 70).

17 *Id.* §§ 292.304(b)(2)-(4).

18 *Id.*; *id.* § 292.304(e).

19 *Id.* § 292.304(b)(4).

20 *Id.* § 292.303(c)(1).

Federal Power Act's sections 210[21] and 212,[22] which were added to and amended by sections 202[23] and 204[24] of PURPA.

Fourth, the Commission would not include criteria relating directly to "fuel use" in its rules with respect to what cogenerators are to be deemed "qualifying facilities."[25]

We shall consider each of these issues in turn.

II. ANALYSIS

A. *Full Avoided Cost*[26]

Section 210, "Cogeneration and small power production," of PURPA reads in relevant part:

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21 16 U.S.C. § 824i (Supp. III 1979).

22 *Id.* § 824k.

23 *Id.* § 824i.

24 *Id.* § 824k.

25 FERC did include fuel use criteria in defining qualifying small power production facilities; indeed, it was required by statute to do so. *Id.* § 796(17)(A)(i).

26 The Commission has challenged the standing of petitioners with respect to the full avoided cost and simultaneous transaction issues. It also challenges the ripeness of the full avoided cost issue. We find both challenges to be without merit.

It is well established that "one who has been injured by agency action is presumptively entitled to judicial review." *City of Rochester* v. *Bond*, 603 F.2d 927, 931 (D.C. Cir. 1979). The injury which the full avoided cost rule causes the petitioners is clear. If petitioners prevail before this court, the rule will be changed to permit the states to allow the petitioners to purchase electricity at prices lower than those now required. Nor do we find persuasive FERC's argument that utilities nevertheless cannot be aggrieved because they will "recover their costs in the regulated rates they charge their customers." A utility might or might not be allowed to raise its rates after a likely, lengthy, and costly proceeding before the state utility commission. (The divergent interests of the utilities and the state commissions lead us also to reject FERC's argument that utilities should find the full avoided cost rule unobjec-

(b) RATES FOR PURCHASES BY ELECTRIC UTILITIES

The rules prescribed [by FERC] . . . shall ensure that, in requiring any electric utility to offer to purchase electric energy from any qualifying cogeneration facility or qualifying small power production facility, the rates for such purpose—

(1) shall be just and reasonable to the electric consumers of the electric utility and in the public interest, and

(2) shall not discriminate against qualifying cogenerators or qualifying small power producers.

No such rule prescribed . . . shall provide for a rate which exceeds the incremental cost to the electric utility of alternative electric energy.[27]

Sections 292.304(b)(2) and (b)(4) of FERC's rules require utilities to purchase electricity from qualifying facilities at a rate that "equals" each utility's full avoided cost.[28] By re-

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tionable since FERC's rule 18 C.F.R. § 292.403 (1980) allows "the State regulatory authority" to apply to FERC for a waiver of the rule.)

Moreover, public utilities have an obligation to minimize their costs consistent with their obligation to provide adequate service. *See Texas E. Transmission Corp.* v. *FPC*, 414 F.2d 344 (5th Cir. 1969), *cert. denied*, 398 U.S. 928 (1970). Furthermore, utilities have consistently been allowed to challenge set rates. *See, e.g., Public Sys.* v. *FERC*, 606 F.2d 973 (D.C. Cir. 1979); *Sierra Pac. Power Co.* v. *FPC*, 223 F.2d 605 (D.C. Cir. 1955), *aff'd*, 350 U.S. 348 (1956). And finally, the Federal Power Act at 16 U.S.C. § 825*l* (1976) grants petitioners, as "person[s] . . . aggrieved," standing to challenge FERC's regulations. *See Scanwell Laboratories, Inc.* v. *Shaffer*, 424 F.2d 859 (D.C. Cir. 1970); *National Coal Ass'n* v. *FPC*, 191 F.2d 462 (D.C. Cir. 1951).

As for ripeness, the Federal Power Act precludes review of Commission orders unless sought within 60 days of the Commission's order on rehearing. 16 U.S.C. § 825*l*(b) (1976). Thus if the petitioners fail to pursue their remedies now, they do so at the peril of losing the right ever to challenge the validity of the Commission's regulations.

27 16 U.S.C. § 824a-3(b) (Supp. III 1979).

28 18 C.F.R. §§ 292.304(b)(2)-(4) (1980). What the Commission there calls its full "avoided" cost standard is identical to the statutory concept of the "incremental cost . . . of alternative energy."

quiring the utility to pay the cogenerator exactly what it would have cost the utility to produce the power itself or buy from another source, these rules foreclose the states, unless they apply for and receive a waiver from FERC, from ordering the sharing of any of the benefits of the transaction with the other customers of the utility.

The question before us is whether this result is consistent with the statutory mandate that the rates set by the Commission must, in addition to not discriminating against cogenerators, also be "just and reasonable to the electric consumers of the electric utility" and "in the public interest." We hold that FERC has not adequately justified its adoption of the full avoided cost standard. Therefore the FERC rule is vacated and the matter remanded to the Commission.

Congress could have required the Commission to set rates at full avoided cost. However, Congress did not do so. Instead it specified the three other criteria—the "public interest," and the interests of cogenerators and "electric consumers of electric utilit[ies]"—which the Commission was to consider in setting rates. It is apparent that the Commission did not do this, or at least if it did its rationale and process of consideration were never made explicit. Instead the Commission came to the simplistic and uniform conclusion that the full avoided cost standard would be just and reasonable in every case and that this was necessary to encourage cogeneration in every case.

Congress's *Conference Report on the Public Utility Regulatory Policies Act*[29] makes clear that section 210(b)'s incremental cost *limitation* is not to become a substitute for the "just and reasonable" standard.

> [T]he utility would not be required to purchase electric energy from a qualifying cogeneration or small power production facility at a rate which exceeds the lower of the rate described above, namely a rate which is just and reasonable to consumers of the utility, in the public

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29 Conference Report on the Public Utility Regulatory Policies Act, H.R. Rep. No. 1750, 95th Cong., 2d Sess. (1978).

> interest, and nondiscriminatory, or the incremental cost of alternate electric energy. This limitation on the rates which may be required in purchasing from a cogenerator or small power producer is meant to act as an *upper limit* on the price at which utilities can be required under this section to purchase electric energy.[30]

By ordering that the purchase rate be equal to the full avoided cost in every case, FERC has, without convincing explanation, simply adopted as a uniform rule the maximum purchase rate specified in the statute. Congress made a clear distinction between a "just and reasonable" rate and a rate based on the full avoided cost, though the two *may* coincide. It has long been held that the essence of the just and reasonable standard is a balancing of the interests of the affected parties.[31] Although FERC was *not* to subject cogenerators to complex, traditional utility-type regulation, it was compelled to consider the hard questions which the standard necessarily raises.

The Commission's brief points out, correctly, that the *Conference Report* stated that "the purchase by the utility of the cogenerator's or small power producer's power should not be burdened by the same examination as are utility rate applications, but rather in a less burdensome manner."[32] This sentence, however, does not stand for the proposition that cogenerator applications are to be given *no* examination, but—as the sentence itself says—that these examinations are simply to be conducted "in a *less* burdensome manner." However unburdensome this manner might be, it requires at a minimum that the Commission make clear and explain how the rates it sets are consistent with the statutory criteria. In the case at hand this was not done.

The Commission gave only three reasons for the adoption of its standard. It stated that any benefits to utility customers

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30 *Id.* at 98 (emphasis added).

31 *See, e.g., FPC* v. *Hope Natural Gas Co.*, 320 U.S. 591, 603 (1944).

32 Conference Report on the Public Utility Regulatory Policies Act, H.R. Rep No. 1750, 95th Cong., 2d Sess. 98 (1978).

would lead to "insignificant" rate reductions, that a "split-the-savings" rule would result in precisely the sort of utilities-type regulation which PURPA was designed to avoid, and that allocating all the savings to cogenerators "may provide a significant incentive for a higher growth rate of these technologies."[33] We find these reasons inadequate.

Since the Commission is required by statute to consider the impact of its rate setting on "electric consumers of the electric utility" it is especially necessary for FERC to demonstrate the factual basis for its conclusion of "insignificant" savings for them. The Commission should bear in mind, as Congress surely knew, that inevitably the impact of FERC's rules per consumer will be less than their impact per cogenerator. Moreover, it is possible that if cogeneration becomes substantial, a rate uniformly set at the statutory ceiling may be quite costly to electric consumers. The Commission may be right in its conclusion, but it needs to make its reasoning and findings explicit.

Similarly, the Commission's assertion that a split-the-savings rule would require utilities-type regulation in contravention of the purpose of PURPA is inadequate. FERC appropriately rejected a split-the-savings approach, which would involve calculation of cogenerator costs, since such rate setting would indeed veer toward the public utilities-style rate setting that Congress wanted to avoid. But as the Commission recognizes, there are alternatives to the full avoided cost rule besides the split-the-savings approach, and these may require *no* consideration of the cogenerator's costs. The Commission recognizes, for instance, that it could have permitted state authorities to set purchase rates at some percentage of avoided cost.[34] This approach would not necessarily require any inquiry into the cogenerator's costs, but only into those of the utility.

Finally, in rejecting even this "percentage" alternative to the full avoided cost rule, the Commission asserts that any rate

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33 Record at 3457-60. Compare this with the extensive rationale given by FERC for its non-adoption of fuel use criteria, discussed at pp. 27-37 *infra*.

34 Record at 3459.

below the statutory maximum it has adopted might be insufficient to induce some potential cogenerators either to begin or to continue to cogenerate.[35] Thus, the Commission holds that the bare, unquantified possibility that a rule permitting rates at less than full cost *might* be insufficient to encourage the last kilowatt hour of cogeneration justifies shutting the utility's customers out of any share of the benefits. But this seems entirely inconsistent with the clear intent of section 210(b), which seeks to strike a balance among the interests of cogenerators, "electric consumers of electric utilit[ies]," and the "public interest." FERC should allocate the benefits more evenly between the cogenerators and the utilities if the utilities can demonstrate that, under a percentage of avoided cost approach, an allocation less heavily favoring the cogenerators is in the public interest and the interest of the utilities' electric consumers, and will not disproportionately discourage cogeneration.

It is clear that FERC has failed to meet its obligation to provide the public with the reasoned consideration, decisionmaking, and opinion which it is required to give.[36] On remand we expect the Commission to take a harder look at, especially, the percentage of avoided cost approach. Such an approach might, for example, entail FERC setting a specific percentage, or FERC might permit state commissions to set rates within a range—*e.g.*, 80-100 percent—authorized by the Commission.

We shall now outline some additional concerns raised by the full avoided cost rule, which the Commission should address in its subsequent rulemaking.

It is clear that at least the possibility exists that setting the rates which utilities must pay to cogenerators at too high a level may hurt both "the electric consumers of the electric utility" and the "public interest." This may occur, for example, where the utility is subject to higher pollution control standards than are cogenerators, or when it pays taxes at a higher

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35 *Id.* at 3460.

36 *See generally Public Sys.* v. *FERC*, 606 F.2d 973 (D.C. Cir. 1979).

rate than will cogenerators. In such cases the Commission's rule would presumably violate both the "public interest" and the "just and reasonable" standards of the Act, unless FERC found that the cogenerator provided sufficiently countervailing external public benefits. While we recognize that such costs may not be easily quantifiable, especially at this initial stage of regulation, the Commission may find it possible to take them into account.

Furthermore, if a utility has excess capacity the additional cogeneration encouraged by full avoided cost payments will result in higher rates for all remaining customers of the utility, because that cogeneration will reduce the number of customer-purchased kilowatt-hours over which the utility can spread a share of the fixed costs of that extra capacity. While the regulations will not thereby increase the utility's total cost, they will increase the share of those costs borne by each remaining customer. So long as the regulations largely preclude those remaining customers from receiving any offsetting benefit that would result from purchase rates below full avoided cost, the regulations will make those customers—the beneficiaries of the just and reasonable standard—worse off.

Likewise, *the full avoided cost rule may disadvantage utility customers in other ways.* But for FERC's regulations, the utility may have paid a cogenerator a market purchase rate of something less than the full avoided cost, under a standard industry practice.[37] Since a rate which is below full avoided cost, but still above the cogenerator's cost, could suffice to induce cogeneration, a full avoided cost rule would not be required to meet the statutory directive to encourage cogeneration. Thus, by requiring the payment of full avoided cost to any new cogeneration facility (including those which would have been installed even though purchase rates are less than

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37 There is a traditional manner in the electric utility industry by which two entities which exchange power determine the price of that power, the so-called split-the-savings approach; the price is set somewhere between the incremental cost of the buying utility and the incremental cost of the selling utility, so that each benefits by the transaction. *See* Record at 3455-56.

full avoided cost), the regulations could both fail to induce additional cogeneration and leave the utility and its customers worse off than they might otherwise have been.

We do not say, of course, that the Commission must adopt rules which have no adverse impact on electricity consumers. But we do say that the Commission must consider the rules' impact on these consumers and the public interest in striking the proper balance.

While Congress chose to regulate the market because utilities in the past acted to prevent the participation of cogenerators in the market,[38] the statute does not preclude all consideration of market forces. *Indeed, the command that the interests of consumers and the public be taken into account contemplates consideration of the degree to which market forces may encourage utilities to purchase, and cogenerators to sell, a substantial amount of cogenerated power at a price lower than the statutory limit.*

Cogenerative facilities are no monopoly. They are variously located, they depend on various types of power generation, they have varying excesses of power at different times to sell, and the public utilities to which they sell also have varying demands for additional power. There is nothing very uniform about either the cost or quantity or location or availability of the power generated by any cogenerative source, and the utility to which it sells has many other power sources, including other cogenerators, from which to choose.

This is precisely the type of situation which, assuming that utilities are similarly competitively constrained, the market pricing system admirably regulates, without the intervention of any government agency. The cogenerative sources are not monopolies in any way, for they simply compete in selling power to the public utility, much as the coal companies or the petroleum companies sell power to the public utility. Thus, if the market were competitive, regulation would be unnecessary and market forces would adjust between the public utility's demand and the cogenerative sources' supply to yield the price

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38 *See* pp. 4-6 *supra.*

and quantity of cogenerative power sold to the public utility. If the public utility's need in a particular area were less, it would buy less, and possibly a smaller amount of cogenerative power would be encouraged. But *by this price mechanism the consumer would benefit* by having available additional power at a lower cost than the utility could itself generate that power, and the cogenerative source would benefit by selling power it did not need. It may be possible for the Commission to examine the market forces and set a price, or a price range, for cogenerated power that will allocate to the consumer some of the benefits of a competitive market.

It is this sensitive market mechanism which historically and repeatedly the federal regulatory agencies have found so extremely difficult to replicate. Congress clearly wanted to avoid the stultifying effects of complete public utility regulation in the competitive situation here where it was obviously not needed, although a purely market pricing mechanism for cogenerative power might have been thought incompatible with public utility regulation of the principal source. The mandate of the agency is to balance the interests of cogenerators, consumers, and the public interest. This will be a complex matter, but it is the duty of the agency to try, which apparently it has not done so far. If the agency finds it impossible to achieve by regulatory rules an equitable balance of interests, then it should advise Congress of what is needed in the way of statutory change to achieve the congressional objectives of consumer protection and development of additional power sources.

The upshot of the above is that where competitive forces exist, the Commission should take them into account in determining the degree and type of regulation necessary. Cogenerators are in the same position as coal or oil producers—if they are offered a sufficient price by the public utilities and are relieved from burdensome utility-type regulation, they will produce the needed power and sell it to the public utilities. One reason that these sources have not done so before is that they feared regulation as public utilities. The law which Congress passed was intended to correct the market distortions caused

by government regulations and by the utilities—not to create new ones.

The above discussion assumes that the utilities, as well as the cogenerators, are subject to some competitive restraints. If, on the other hand, the utilities are monopsonists with respect to cogenerators, then the Commission may be justified in its present regulation of rates charged by utilities. However, this is precisely the sort of determination which FERC should make explicit and explain, and it has not done so. Moreover, even if the utilities are monopsonists, it does not necessarily follow that the proper rate level is at full avoided cost. Again, the Commission must explain why the level was set here rather than somewhere else.

We hold therefore that FERC must justify and explain its decision to prohibit in an across-the-board manner rates below full avoided cost. Since it has failed to do so, its rule is vacated.

We recognize that it would probably be an untoward burden and expense to determine permissible rates on a case-by-case, or perhaps even on a cogeneration method-by-cogeneration method basis. Such a requirement would, in fact, be inconsistent with the overarching congressional intent to streamline rather than impede the implementation of cogeneration. Thus our holding should not be read as requiring FERC to establish different standards for a variety of cogeneration cases and methods. A general rule is acceptable, but the Commission must justify and explain it fully, particularly in its balancing of the interests of cogenerators, the public interest, and "electric consumers of the electric utilit[ies]."

B. *Simultaneous Purchase and Sale*[39]

A customer of a utility who needs electric energy for his own industrial purposes may produce it at his own plant or buy it from the local utility. However, if such a customer is unable simultaneously to buy from, and sell power to, the utility, he

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39 *See* note 26 *supra*.

will generally find it uneconomical to generate energy himself even though he may be able to do so more efficiently than the utility. That is not an unusual situation in view of the fact that a utility's retail rate is generally lower than the utility's incremental cost of producing additional capacity or energy.[40] In such circumstances, the prudent customer will allow the utility to build and operate the more expensive plant and supply customers, even though the utility's plant will cost society more than if the customer built a generating plant.

The regulations promulgated by FERC permit a cogenerator, at his option, to indulge in the fiction that the electricity he generates for his own use is simultaneously purchased by a utility and sold back to him.[41] The regulations enable new qualifying small power producers and cogenerators to sell to the utility all of their electric output at the purchasing utility's full avoided cost, and to purchase from the utility any electricity they may need at the traditional retail rate.

Petitioners challenge this rule on two plausible grounds. First, they argue that the Commission has misconstrued the statutory terms "purchase" and "sale." That is, they argue that because the rule here requires utilities to treat cogenerators as if they have engaged in a purchase and sale when in fact none might have occurred, it is violative of the plain meaning of section 210(a) of PURPA, under which the rule was promulgated:

> [The Commission shall] prescribe . . . such rules as it determines necessary to encourage cogeneration and small power production which rules require electric utilities to offer to—
>
> (1) *sell* electric energy to qualifying cogeneration facilities and qualifying small power production facilities and
>
> (2) *purchase* electric energy from such facilities.[42]

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40 The retail rates of utilities have traditionally been based on embedded—*i.e.*, average—costs which are normally less than incremental costs.

41 18 C.F.R. § 292.304(b)(4) (1980).

42 16 U.S.C. § 824a-3(a) (Supp. III 1979) (emphasis added).

Yet it is clear, and petitioners conceded at oral argument, that FERC could have achieved the identical result where the cogenerator in fact engages in an actual sale of all his output to, and an actual purchase of all his input from, the utility. It would be anomalous indeed to treat differently the cogenerator who consumes all the power he generates and one who sells his surplus. Under these circumstances it seems unlikely that Congress intended the narrow definition of "purchase" and "sale" which petitioners urge upon us.

Moreover, it is arguable that the statute itself impels the simultaneous transaction rule. The statute requires non-discriminatory rates for cogenerators, and it is at least plausible that the Commission could find that *not* invoking a simultaneous transaction rule would in fact result in cogenerators paying discriminatory rates. That is, in the absence of a simultaneous transaction rule and assuming that there was no physical purchase or sale between the utility and the cogenerator, the person who chose to cogenerate would pay more for his power than the person who chose to buy from a utility. As discussed earlier,[43] this is a result of the structure of utility rates and can happen even if the cogenerator can generate energy more efficiently than the utility, since the cogenerator must pay his cost of cogeneration and the non-cogenerator must pay only the relatively and artificially lower utility retail rates. Moreover, as was explained in the preceding paragraph, in the absence of FERC's rule the cogenerator who consumes all his power would be treated (discriminatorily) differently from one who sells his surplus. Under these circumstances the Commission could properly require that these effects be avoided by adopting, as it did here, a simultaneous transaction rule.

Finally, it should be borne in mind that one of the most basic purposes of PURPA was to remove the obstacle to cogeneration involved here: utilities were often unwilling to purchase the electric output at all or at an appropriate rate from

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43 *See* pp. 18-19 *supra*.

cogenerators.[44] Under these circumstances we are inclined to give a great deal of deference to FERC's regulations.[45]

Petitioners' second complaint is that the Commission did not adequately consider and explain its decision to require utilities to engage in the simultaneous transaction fiction. Petitioners' argument here parallels its challenge to the Commission's adoption of the full avoided cost rule.

While we find for petitioners on the latter point, we believe that in the matter of the simultaneous transaction fiction the Commission's consideration and explanation of its decision were adequate. The questions begged by the Commission's scanty findings with respect to its adoption of the full avoided cost rule are not raised in the context of its simultaneous transaction rule. The Commission considered the impact on consumers of its rule and concluded that "the utility's customers would benefit whenever a [cogenerator] builds a lower-cost plant than the utility can build, [so] we tentatively recommend that this simultaneous buying and selling be permitted in connection with new facilities."[46] As this passage also indicates, the Commission's simultaneous transaction rule is limited to new qualifying small power producers and cogenerators.

That the Commission considered the impact of its rule on all interested parties is reflected in its "Notice of Proposed Rulemaking Regarding the Implementation of Section 210 of the Public Utilities Regulatory Policies Act of 1978":

> As observed in the Staff discussion paper, an efficient use of society's resources requires that when there is a need for additional capacity, and a utility's customer can construct a new plant more cheaply than a utility can, he should be encouraged to do so. A qualifying facility may have previously used a portion of its electric output to

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44 *See* pp. 4-6 *supra*.

45 Of course, this deference does not extend to regulations not promulgated in conformity with the statute. *See* Part II-A, pp. 8-18 *supra*, and Part II-C, pp. 23-27 *infra*.

46 Record at 2417.

> supply its own power needs. That it chose to generate its own electric power, rather than purchase such power from an electric utility, indicates that there were sufficient economic incentives to so act. To permit such a facility to sell that portion of its electric output to the utility at the utility's avoided costs and replace that electricity from the electric utility at non-incremental (and presumably lower) rates would increase the purchase power costs of the purchasing utility and thus would increase the rates charged to the utility's other customers. The Commission believes that it is not necessary to the encouragement of cogeneration and small power production that a qualifying facility be permitted to obtain avoided cost-based rates for this portion of its electric output. Accordingly, the Commission proposes that for energy generated by a new facility or by capacity installed after the date of issuance of these rules, a qualifying facility be permitted to sell its output at rates established under the section 210(b) of PURPA pricing mechanism while simultaneously purchasing electric energy from a utility pursuant to its retail rate schedules.[47]

Thus we find FERC's rule to be consistent with PURPA and to have been adequately justified by the Commission. Accordingly, we uphold the rule.

C. *Interconnection*

An "interconnection" is a physical connection that permits electricity to flow from one entity to another. The interconnections at issue here are not the usual ones by which a customer takes power *from* a utility but rather those which permit a cogenerator to transmit electricity *to* a utility. Petitioners argue that one of the rules promulgated by FERC is inconsistent with

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47 FERC, Notice of Proposed Rulemaking Regarding the Implementation of § 210 of the Public Utilities Regulatory Policies Act of 1978, at § 292.107 (18 Oct. 1979) (footnote omitted), *reprinted in* Record at 2702-47 to 2702-48.

the Federal Power Act (FPA), as amended and added to in relevant part by PURPA. We agree.

We turn first to the statutes. FPA section 210(c)[48] provides that the Commission may issue an interconnection order with respect to a qualifying cogenerator *only if* the interconnection is in the public interest; would encourage overall conservation of energy or capital, optimize the efficiency of the use of facilities and resources, or improve a utility system's reliability; and meets the requirements of FPA section 212[49] that, inter alia, the interconnection is not "likely to result in a reasonably ascertainable uncompensated economic loss" for any utility or cogenerator, will not place an "undue burden" on any party, will not "unreasonably impair the reliability" of the utility, and will not "impair" the utility's ability "to render adequate service to its customers." FPA section 210(b)[50] provides that the Commission is to give appropriate notice and afford an evidentiary hearing before issuing any such order, and FPA section 212 contains certain specific financial and procedural protections for the party ordered to interconnect (for these purposes, the utility). Section 210(a)(1) of the FPA, as added to and amended by PURPA, states:

> Upon application of any electric utility, Federal power marketing agency, qualifying cogenerator, or qualifying small power producer, the Commission may issue an order requiring—
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> (A) the physical connection of any cogeneration facility, any small power production facility, or the transmission facilities of any electric utility, with the facilities of any such applicant . . . .[51]

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48 16 U.S.C. § 824i(c) (Supp. III 1979).

49 *Id.* § 824k.

50 *Id.* § 824i(b).

51 *Id.* § 824i(a)(1).

Finally, and most significantly, section 210(e)(3) of PURPA states:

> No qualifying small power production facility or qualifying cogeneration facility may be exempted under this subsection from—
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> . . . .
>
> (B) the provisions of section 210, 211, or 212 of the Federal Power Act . . . or the necessary authorities for the enforcement of any such provision of the Federal Power Act . . . .[52]

Against this statutory background, FERC promulgated rule 292.303(c)(1), which reads:

> 292.303 *Electric utility obligations under this subpart.*
>
> . . . .
>
> (c) Obligation to interconnect.
>
> (1) . . . [A]ny electric utility shall make such interconnections with any qualifying facility as may be necessary to accomplish purchases or sales under this subpart.[53]

Petitioners assert, and we find, that this rule is inconsistent with the statutes.

By requiring "*any*" utility to make interconnections with "*any*" cogenerator FERC designates, the Commission would in effect exempt qualifying cogenerators from the other procedural and substantive requirements discussed above in FPA sections 210 and 212, and deprive utilities of the safeguards afforded by those provisions. Section 210(e)(3) of PURPA

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52 *Id.* § 824a-3(e)(3).

53 18 C.F.R. § 292.303(c)(1) (1980). The "subpart" referred to is "Subpart C—Arrangements Between Electric Utilities and Qualifying Cogeneration and Small Power Production Facilities Under Section 210 of the Public Utility Regulatory Policies Act of 1978."

makes clear that FERC may not do this: "No . . . qualifying cogeneration facility may be exempted . . . from the provisions of section 210, 211, or 212 of the Federal Power Act . . . or the necessary authorities for enforcement of any such provision under the Federal Power Act. . . ."[54]

FERC argues that compliance with the literal meaning of the statutory sections would impose an undue burden upon cogenerators. However, the Commission need not impose substantial administrative burdens on those facilities, but rather can adopt streamlined procedures. If the Commission believes that even streamlined procedures are too burdensome, the necessary amendment must come from Congress. FERC's argument extolling the wisdom and popularity of its interpretation is necessarily unavailing when Congress has explicitly chosen a policy to the contrary. As much can be said of the Commission's arguments that the procedures of FPA sections 210 and 212 and PURPA, respectively, would add nothing to the utilities' safeguards built into the Commission's rule on interconnection. The Commission cannot justify its transgression of the statute by saying that it is not convinced that it makes any difference.

The Commission also offers the following argument:

> . . . [S]ection 212(e) of the Federal Power Act states that no provision of the interconnection requirements of the Federal Power Act shall be treated "(1) as requiring any person to utilize the authority of such section 210 or 212 [of the Federal Power Act] in lieu of any authority of law, or (2) as limiting, impairing, or otherwise affecting any other authority of the Commission *under any provision of law*" [emphasis supplied]. As this language plainly shows, the interconnection provisions of the Federal Power Act do not provide the exclusive remedy, where the requirements of Section 210 of PURPA—*i.e.*, "any other provisions of law"—are satisfied.[55]

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54 16 U.S.C. § 824a-3(e)(3) (Supp. III 1979).

55 Brief for Respondent at 64 (brackets in the original).

We find this argument to be wholly unconvincing. FERC contends that the authority it has to encourage cogeneration—one tool for which, it argues, is to grant authority for cogenerators to interconnect with utilities without meeting the other requirements of sections 210 and 212 of the Federal Power Act—cannot be attenuated by other statutory provisions. That is, FERC argues that it has been given specific authority to make the interconnection rule and that other statutory provisions cannot be read as limiting that authority. This assumes the conclusion. It is true that section 212(e) of the FPA was intended to keep specific grants of authority from being vitiated by the general limitations on authority in sections 210 and 212. However, in the case at hand, there is no specific grant of authority involved. Instead, we have a relatively *specific limitation* on authority in PURPA section 210(e)(3) which must control over the relatively *general grant* of authority in FPA section 212(e). The general directive of section 212(e) does not give the Commission a mandate to consign detailed provisions of PURPA itself to the wastebasket as meaningless surplusage. It is well established that

> [h]owever inclusive may be the general language of a statute, it "will not be held to apply to a matter specifically dealt with in another part of the same enactment. . . . Specific terms prevail over the general in the same or another statute which might otherwise be controlling."[56]

Finally, FERC argues that rule 292.303(c)(1) is consistent with PURPA section 210(e)(3) if the latter is interpreted as protecting cogenerators who are *targets* of *other* parties seeking interconnection, and not extended to situations where the cogenerator is an *applicant* for an interconnection itself. While an interesting and not inherently implausible suggestion, the Commission points to no evidence in the legislative history or

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56 *Clifford F. MacEvoy Co.* v. *United States*, 322 U.S. 102, 107 (1944) (quoting *D. Ginsberg & Sons* v. *Popkin*, 285 U.S. 204, 208 (1932)).

the statute itself to justify this interpretation, which is both counterintuitive and inconsistent with the statute's explicit provisions. Nor were we able to find such evidence. Accordingly, we reject the interpretation. The Commission's interconnection rule is hereby vacated.

D. *Fuel Use*

Section 201 of PURPA states:

> "qualifying cogeneration facility" means a cogeneration facility which—
>
> (i) the Commission determines, by rule, meets such requirements (including requirements respecting minimum size, *fuel use,* and fuel efficiency) as the Commission *may,* by rule, prescribe . . . .[57]

The Commission decided against including any fuel use criteria in its definition of qualifying cogeneration facilities. Petitioners challenge this decision as violating the statutory language quoted above, and advocate criteria aimed at limiting oil- and gas-fired cogeneration. FERC argues that the statutory language, on the contrary, gives it the discretion to decide whether or not to include fuel use requirements.

We agree with the Commission for two reasons. First, FERC was not required to establish separate fuel use criteria since the statute says *may,* not must. Second, the regulations it adopted were a reasoned, adequate response to the charge Congress gave it. We consider the two reasons in turn.

1. *Statutory interpretation*

The Supreme Court has repeatedly emphasized that "the starting point for interpreting a statute is the language of the statute itself. Absent a clearly expressed legislative intention to the contrary, that language must ordinarily be regarded as

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[57] 16 U.S.C. § 796(18)(B) (Supp. III 1979) (emphasis added).

conclusive."[58] The analysis of this court in *Sierra Club* v. *Costle*[59] is instructive here, too. In that case we rejected an argument that an agency lacked discretion to adopt emission reduction standards for coal-burning facilities that varied according to the sulfur contents of coal. As we said there, "The absence of any express mandate in this language to adhere to a single percentage reduction standard critically undercuts Sierra Club's arguments that EPA could not vary the standard . . . ."[60] Thus, in the case at hand, in the absence of clear legislative intent to the contrary we decline to read "may" to mean anything but "may."[61] Since the construction of the statute in accordance with its plain meaning does not produce an absurd result, render the statute internally contradictory, or diverge from legislative intent unequivocally expressed in the statute's history, departure from the plain meaning is not warranted.[62]

Other evidence reinforces our conclusion that this interpretation of the statute is the correct one. The Commission reasoned that Congress did not intend to exclude oil- and natural gas-fired cogenerating facilities from qualifying status, because if that were the congressional intent the statute itself would

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58 *Consumer Product Safety Comm'n* v. *GTE Sylvania, Inc.*, 447 U.S. 102, 108 (1980). *See also Lewis* v. *United States*, 445 U.S. 55, 60 (1980); *Touche Ross & Co.* v. *Redington*, 442 U.S. 560, 568 (1979) (and cases cited therein); *Southeastern Community College* v. *Davis*, 442 U.S. 397, 405 (1979) (and cases cited therein); *Reiter* v. *Sonotone Corp.*, 442 U.S. 330, 337 (1979); *United States* v. *Wiltberger*, 18 U.S. (5 Wheat.) 76, 96-97 (1820).

59 657 F.2d 298 (D.C. Cir. 1981).

60 *Id.* at 318.

61 The petitioners' citation of *Calvert Cliffs' Coordinating Comm., Inc.* v. *Atomic Energy Comm'n*, 449 F.2d 1109, 1112-13 (D.C. Cir. 1971), is therefore inapposite. In *Calvert Cliffs'* the statute involved used mandatory language ("shall"), not discretionary language ("may").

62 *See, e.g., Trans Alaska Pipeline Rate Cases*, 436 U.S. 631, 643 (1978).

have contained such a restriction, as it did for small power producers.[63] Moreover, the Commission noted that its interpretation was consistent with the Natural Gas Policy Act of 1978,[64] which expressly allows for exemption from incremental pricing for natural gas used in qualifying cogeneration facilities.[65]

The Commission also concluded that any fuel use restrictions it imposed would apply only to the small facilities Congress had exempted from the Fuel Use Act.[66] By including "fuel use" among the factors that the Commission may consider when qualifying cogenerators, Congress cannot be assumed to have intended to bring small facilities, otherwise exempted, under regulation by the Fuel Use Act just because they seek to become cogenerators. This is underscored by the fact that Congress sought to encourage cogeneration by providing an exemption from fuel use restrictions under the Fuel Use Act for large facilities if they become cogenerators.[67] The Commission concluded that restricting the fuels used by prospective cogeneration facilities if they become cogenerators could simply discourage cogeneration without reducing consumption of oil or natural gas.[68]

Moreover, it should be pointed out that while the conservation of oil and gas was one reason behind the passage of PURPA, it was not the sole reason. The more overarching reason was the efficient allocation and use of this nation's electric energy supplies.[69] Thus petitioners cannot argue that

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63 16 U.S.C. § 796(17)(A)(i) (Supp. III 1979).

64 Record at 2183. The Natural Gas Policy Act of 1978 is codified at 15 U.S.C. §§ 3301-3432 (Supp. III 1979); 42 U.S.C. § 7255 (Supp. III 1979).

65 15 U.S.C. § 3346(c)(3) (Supp. III 1979).

66 Record at 370; *see* 42 U.S.C. §§ 8302(a)(7), (10) (Supp. III 1979).

67 *Id.* § 8322(c).

68 Record at 370-71.

69 16 U.S.C. § 2601(1) (Supp. III 1979).

any policy which might increase the amount of oil and gas used is ipso facto a violation of PURPA, especially when, as here, the language of PURPA specifically authorizes the regulations promulgated. Indeed, the Commission noted that one of PURPA's express purposes is to accomplish "increased conservation of electric energy, increased efficiency in the use of facilities and resources by electric utilities, and equitable retail rates for electric consumers,"[70] and apparently found that fuel use criteria would have the opposite effect, reducing efficient use of facilities and resources.[71] It is also worth noting that Congress was surely cognizant of the rapidly changing nature of the oil and gas import market. The Commission could plausibly argue that the necessity of encouraging every conceivable stopgap measure in order to decrease the reliance on imported oil and gas has declined today from the paramount importance it may have had three years ago when the bill was passed.

2. *FERC's reasoned and adequate consideration*

Turning to the second reason for our upholding of the Commission on this issue, it is clear to us that the regulations promulgated by FERC under the statute were a reasoned and adequate response to the charge Congress gave it. To outline the course of our discussion in this section, we find that FERC considered the advantages and disadvantages of fuel use criteria, but concluded that the burdens they would place on cogeneration, the presence of FERC's fuel *efficiency* criteria, the power of the Department of Energy (DOE) to restrict the fuel use of the largest cogeneration facilities, and the relative pricing of non-petroleum utility power all rendered fuel use criteria unnecessary and undesirable.

In this discussion of why the court concludes that the Commission's rules are reasoned and adequate, two general points should be kept in mind. First of course is that the entire

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70 *Id.*

71 Record at 2182-84.

discussion takes place against the background of our prior finding of discretion for the Commission, so that the most the Commission need show is that its rule was " 'reasonably related to the purposes of the enabling legislation.' "[72] Second, not only do we find each of the reasons discussed below to be convincing separately, but these reasons can be weighted cumulatively, which makes their force overwhelming.

Petitioners claim that "[i]nstead of giving fuel use considerations the 'hard look' required by section 201(18)(B), the Commission gave five reasons for not 'looking' at all."[73] However, it is clear here that petitioners are merely playing a semantic game.[74] If the Commission did give reasons for "not looking," that makes its action indistinguishable from a decision not to invoke fuel use criteria when it *had* looked.

More to the point, the Commission actually did give fuel use considerations the "hard look" that petitioners seek; it simply

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72 *Mourning* v. *Family Publications Serv., Inc.*, 411 U.S. 356, 369 (1973).

Note again that we give more deference to FERC here than had Congress explicitly told FERC to weigh some factor. *Cf.* Part II-A, pp. 8-18 *supra*. *See also* note 45 and accompanying text *supra*.

73 Reply Brief for Petitioners at 49 (footnotes omitted).

74 Petitioners' quotation of the Commission's conclusion that "it is not proper to address this fuel use issue within the context of this program" is at any rate misleading when taken from context. Brief for Petitioners at 62. The context of the sentence is the following paragraph (which was reached, moreover, only after several pages of discussion of possible fuel use criteria):

> Some of the comments stated that permitting cogeneration facilities to use oil, especially in diesel engines, will use up available air quality increments, thereby preventing the conversion of large utility oil-fired boilers to coal. As noted above, the Commission believes it is not proper to address this fuel use issue within the context of this program. However, the Commission has not made a final determination regarding the environmental effects of new diesel cogeneration facilities, and is therefore including in these regulations an interim exclusion from qualification of this technology until work on an environmental impact statement has been completed.

Record at 2184 (Order No. 70, issued 13 March 1980).

concluded for a variety of reasons which we will now discuss that fuel use criteria were inappropriate. That there will inevitably be differences of opinion as to the wisdom and effect of various policies creating incentives and disincentives for cogeneration is apparent; but it is equally apparent that this court has neither the technical expertise nor the constitutional authority to question on the merits the decisions made by an executive branch agency properly empowered by Congress. We can do no more than determine whether the law has been followed, and it is clear that the actions of the Commission are within the delegation made to it by Congress.

The Commission held hearings in various cities to gather testimony regarding its proposals, including the desirability of fuel use criteria, and the record is replete with voluminous written comments that were received and considered. Many of those commenting at the hearings agreed with the Commission that stringent fuel use criteria should be avoided.[75] There was also testimony to the effect that a fuel savings requirement would discourage cogeneration.[76] The Economic Regulatory Administration (ERA) elsewhere acknowledged the burden of these requirements by proposing an amendment easing the evidentiary requirement for cogenerators in areas of the country where most utilities burn oil to generate electricity.[77] The ERA determined that oil-fired cogeneration would in many cases result in a net savings of oil. Similarly, the Commission argued that "a restriction on the use of gas or oil for cogeneration, imposed by the Commission, could discourage cogeneration at the lower heat input levels, while not significantly reducing the use of oil or natural gas."[78] Petitioners object to the use of "the unquantified and unexplained 'fudge' words

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75 Record at 714-15, 774, 1258-59, 2098-99, pp. 71DC2-74DC2 in vol. 1 of D.C. hearings. *See also* Record at 2205-08.

76 *See id.* at 2103-2105 (comment of the California Public Utilities Commission).

77 45 Fed. Reg. 53,368 (1980).

78 Record at 370-71.

'could' and 'significantly,' "[79] but the problems confronting FERC are of first impression and quite possibly unquantifiable. Moreover, we think it worth noting that the language which petitioner uses in criticizing FERC is similarly unquantified and unexplained.

Petitioners themselves concede that a fuel savings requirement might place a "burden on oil and gas fired facilities," but argue that the burden "need not be substantial."[80] They argue that the Commission could provide for "reasonably limited, streamlined procedures." Petitioners' argument continues: "The requisite information on the cogenerator's fuel use must be known to it in order for it to determine the economic viability of the project, and the utility's fuel use should be known by the state regulatory authority."[81] But, as is clear from petitioners' own language here, burdens *would* be placed on prospective cogenerators. That the burdens may seem small goes again to the weight of the factors relied upon by FERC, not their existence. As we stated before, we need not engage in a weighing process in the matter now before us.

Moreover, it is by no means clear that—even assuming arguendo that the petitioners are correct in their assertion that the burdens *should* be perceived as relatively light—that the burdens *would* be perceived as light. The obstacles to cogeneration are both psychological and economic.[82] The Commission could rationally find that it is of paramount importance to remove the *appearance* of regulation as well as its reality. A demonstration by the cogenerator of fuel savings, and the requirements that the prospective cogenerator have "[t]he requisite information on . . . fuel use" and that "the state regulatory authority" be consulted, each entail additional and perhaps substantial psychological barriers to the adoption

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79 Brief for Petitioners at 65.

80 Reply Brief for Petitioners at 54.

81 *Id.* at 55 (footnote omitted).

82 *See* pp. 4-6 and accompanying authority *supra*.

of cogeneration. FERC could reasonably have concluded that, to avoid the appearance of regulation, a general rule of no fuel use requirements might be preferable to a more complex rule. Encouraging cogeneration by eliminating the appearance of regulation might result in oil and gas savings greater than would be effected were complicated regulations undertaken.

The importance of avoiding additional regulations was especially important in light of the fact that the Commission decided that it would promulgate fuel *efficiency* regulations, to which subject we next turn.

We find that the Commission's regulation of fuel *efficiency*—instead of fuel *use*—was a reasoned, adequate response to the charge Congress gave it in section 201 of PURPA. Section 201 mentioned "fuel efficiency" as well as "fuel use" in the same list of requirements that the Commission might prescribe.[83] The Commission made clear its belief that the establishment of minimum efficiency standards for cogeneration facilities would ensure the efficient use of scarce fuels.[84] The Commission specifically observed that so long as cogeneration facilities provide for more efficient use of scarce fuels the national purpose is served.[85] The efficiency standards adopted by the Commission have much the same effect that the fuel use criteria would have, insofar as these efficiency criteria are strictest for cogeneration facilities using oil or gas.[86] The Commission also proposed efficiency standards (although less stringent ones) for facilities using other fuels that are limited in availability such as biomass. It imposed no efficiency standards on facilities using coal or coal-derived fuel, reasoning that "[t]he abundance of this energy resource permits reliance on the market to optimize efficiency."[87] The Commission's

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83 16 U.S.C. § 796(18)(B)(i) (Supp. III 1979).

84 Record at 372 (proposed regulations) (issued 27 June 1979).

85 *Id.* at 2183-84.

86 *Id.* at 371-74.

87 *Id.* at 374.

proposed efficiency standards are higher for gas and oil in order to ensure that these fuels are put to efficient use.[88] Finally, acknowledging that efficiency standards are not useful for bottoming cycle facilities, the Commission promulgated efficiency standards for such facilities *only* to the extent they use oil or gas for supplementary firing to generate electricity.[89]

The Commission also justified its decision not to invoke fuel use criteria by pointing out that the Department of Energy has authority to restrict the fuel use of those cogeneration facilities which have a design capability of consuming fuel at the rate of at least 100 million BTU's per hour.[90] Thus FERC declared in Order No. 70 that "the Commission does not believe it necessary or appropriate to require an additional layer of fuel use regulation on technologies which the Commission is charged with encouraging and for which another agency has authority to restrict fuel use."[91] Petitioners argue that this reason has attenuated importance since only some cogenerators meet the 100 million BTU's per hour standard. However, the issue before us remains less the weight of FERC's reasons than their existence.

Finally, the Commission reasoned that fuel use criteria were unnecessary since—because the operation of coal-, nuclear-, or hydro-powered generating stations is much less expensive than operating oil- or gas-fired plants—a cogenerator in most places will find it more economical to purchase utility-generated electricity when that power is coal-, nuclear-, or hydro-generated and the cogenerator uses oil or gas. The Commission thus decided that these market forces "rather than an additional layer of Federal fuel use regulation" should determine the appropriate use of oil and gas.[92] Petitioners question the

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88 *Id.* at 372-74.

89 *Id.* at 2217.

90 *See, e.g.*, 42 U.S.C. §§ 8302(a)(7)(A)(i), 8302(a)(10)(A)(i), 8311, 8312, 8341, 8342 (Supp. III 1979).

91 Record at 2183.

92 *Id.* at 2382.

economic model on which the respondents' argument is based. However, it is not for this court to decide among Chicagoan, Austrian, or Harvardian economic models. Again, the only question properly before us is whether the Commission has based this decision on some plausible evidence.

Thus we conclude that the Commission was granted discretion in its decision to invoke or not to invoke fuel use criteria and that its decision not to do so was a reasoned and adequate response to Congress' charge. FERC considered the advantages and disadvantages of such criteria, and concluded that the burdens they would place on cogeneration, the presence of its fuel efficiency criteria, the power of DOE to restrict the fuel use of the larger facilities, and the price of non-petroleum utility power all rendered fuel use criteria unnecessary or undesirable or both.

III. Conclusion

On the four issues before us today we hold: (1) With respect to FERC's "full avoided cost" rule, FERC did not justify and explain its decision to adopt the rule. Its present rule is hereby vacated. Presumably FERC will want to reconsider its whole position on this problem in the light of this opinion. (2) FERC's "simultaneous transaction" rule is left standing, since it is consistent with congressional intent. (3) FERC's grant of blanket authority to cogenerators to "interconnect" with electric utilities without meeting the requirements of sections 210 and 212 of the Federal Power Act, on the other hand, disregards the relevant statutory provisions. The Commission rule granting this authority is hereby vacated. (4) Finally, we hold that FERC's decision not to invoke "fuel use" criteria in determining what cogeneration facilities are qualifying facilities eligible for the benefits of PURPA is reasoned and in accord with the statute.

So ordered.

UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

No. 80-1789

September Term, 1981

AMERICAN ELECTRIC POWER SERVICE CORPORATION, ET AL.,
Petitioners,

—v.—

FEDERAL ENERGY REGULATORY COMMISSION,
Respondent,

ELIZABETHTOWN GAS COMPANY, AMERICAN PAPER INSTITUTE, INC., BROOKLYN UNION GAS CO., and OCCIDENTAL GEOTHERMAL, INC.,
Intervenors.

Before:

ROBINSON, *Chief Judge,*
WILKEY and GINSBURG, *Circuit Judges.*

ORDER

IT IS ORDERED, *sua sponte,* that the Clerk shall withhold issuance of the mandate herein until seven days after disposition of any timely petition for rehearing. See Local Rule 14, as amended on November 30, 1981. This instruction to the Clerk is without prejudice to the right of any party at any time to move for expedited issuance of the mandate for good cause shown.

FOR THE COURT:

GEORGE A. FISHER
Clerk

UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

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Petitioners,

—v.—

FEDERAL ENERGY REGULATORY COMMISSION,

Respondent,

ELIZABETHTOWN GAS COMPANY, ET AL.,

Intervenors.

Before:

ROBINSON, *Chief Judge;*
WILKEY and GINSBURG, *Circuit Judges.*

ORDER

Upon consideration of the joint motion of intervenors American Paper Institute, Inc. and Occidental Geothermal, Inc. for stay of mandate, and the response of petitioners in opposition thereto, it is

ORDERED, by the Court, that the aforesaid motion is granted and the mandate herein is stayed for a period of 30 days from the date of this order.

Per Curiam

FOR THE COURT:

By s/ GEORGE A. FISHER
Clerk

UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

No. 80-1789

September Term, 1981

AMERICAN ELECTRIC POWER SERVICE CORPORATION, ET AL.,

Petitioners,

—v.—

FEDERAL ENERGY REGULATORY COMMISSION,

Respondent,

ELIZABETHTOWN GAS COMPANY, AMERICAN PAPER INSTITUTE, INC., BROOKLYN UNION GAS CO., OCCIDENTAL GEOTHERMAL, INC.,

Intervenors.

Before:

ROBINSON, *Chief Judge;*
WILKEY and GINSBURG, *Circuit Judges.*

ORDER

Upon consideration of respondent's (Federal Energy Regulatory Commission) motion to stay mandate, and no opposition having been filed thereto, it is

ORDERED, by the Court, that respondent's aforesaid motion is granted and the Clerk is directed not to issue the mandate herein prior to May 11, 1982.

Per Curiam

FOR THE COURT:

By s/ GEORGE A. FISHER
Clerk

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Docket No. RM79-55

Before Commissioners:

Charles B. Curtis, *Chairman;*
Georgiana Sheldon, Matthew Holden, Jr.,
and George R. Hall

SMALL POWER PRODUCTION AND COGENERATION FACILITIES—RATES AND EXEMPTIONS

Order No. 69

FINAL RULE REGARDING THE IMPLEMENTATION OF SECTION 210 OF THE PUBLIC UTILITY REGULATORY POLICIES ACT OF 1978

(Issued February 19, 1980)

Section 210 of the Public Utility Regulatory Policies Act of 1978 (PURPA) requires the Federal Energy Regulatory Commission (Commission) to prescribe rules as the Commission determines necessary to encourage cogeneration and small power production, including rules requiring electric utilities to purchase electric power from and sell electric power to cogeneration and small power production facilities. Additionally, section 210 of PURPA authorizes the Commission to exempt qualifying facilities from certain Federal and State law and regulation.

Under section 201 of PURPA, cogeneration facilities and small power production facilities which meet certain standards and which are not owned by persons primarily engaged in the generation or sale of electric power can become qualifying facilities, and thus become eligible for the rates and exemptions set forth under section 210 of PURPA.

Cogeneration facilities simultaneously produce two forms of useful energy, such as electric power and steam. Cogeneration facilities use significantly less fuel to produce electricity and steam (or other forms of energy) than would be needed to produce the two separately. Thus, by using fuels more efficiently, cogeneration facilities can make a significant contribution to the Nation's effort to conserve its energy resources.

Small power production facilities use biomass, waste, or renewable resources, including wind, solar and water, to produce electric power. Reliance on these sources of energy can reduce the need to consume traditional fossil fuels to generate electric power.

Prior to the enactment of PURPA, a cogenerator or small power producer seeking to establish interconnected operation with a utility faced three major obstacles. First, a utility was not generally required to purchase the electric output, at an appropriate rate. Secondly, some utilities charged discriminatorily high rates for back-up service to cogenerators and small power producers. Thirdly, a cogenerator or small power producer which provided electricity to a utility's grid ran the risk of being considered an electric utility and thus being subjected to State and Federal regulation as an electric utility.

Sections 201 and 210 of PURPA are designed to remove these obstacles. Each electric utility is required under section 210 to offer to purchase available electric energy from cogeneration and small power production facilities which obtain qualifying status under section 201 of PURPA. For such purchases, electric utilities are required to pay rates which are just and reasonable to the ratepayers of the utility, in the public interest, and which do not discriminate against cogenerators or small power producers. Section 210 also requires electric utilities to provide electric service to qualifying facilities at rates

which are just and reasonable, in the public interest, and which do not discriminate against cogenerators and small power producers. Section 210(e) of PURPA provides that the Commission can exempt qualifying facilities from State regulation regarding utility rates and financial organization, from Federal regulation under the Federal Power Act (other than licensing under Part I), and from the Public Utility Holding Company Act.

I. PROCEDURAL HISTORY

On June 26, 1979, in Docket No. RM79-54,[1] the Commission issued proposed rules to determine which cogeneration and small power production facilities may become "qualifying" cogeneration or small power production facilities under section 201 PURPA. Such qualifying facilities are entitled to avail themselves of the rate and exemption provisions under section 210 of PURPA; and qualifying cogeneration facilities are eligible for exemption from incremental pricing under Title II of the Natural Gas Policy Act of 1978.[2] The Commission will soon issue a final rule in Docket No. RM79-54.

As part of the rulemaking process in this docket, the Commission issued a Staff Discussion Paper[3] on June 27, 1979, addressing issues arising under section 210 of PURPA.

Public hearings on RM79-54 and the Staff Discussion Paper (RM79-55) were held in San Francisco on July 23, 1979, Chicago on July 27, 1979, and Washington, D.C. on July 30, 1979. Written comments were also received.

On October 18, 1979, the Commission issued a Notice of Proposed Rulemaking under Section 210 of PURPA in Docket No. RM79-55.[4] On October 19, 1979, the Commission made available its preliminary Environmental Assessment (EA) of

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1 44 F.R. 38873, July 3, 1979.

2 44 F.R. 65744, November 15, 1979.

3 44 F.R. 38863, July 3, 1979.

4 44 F.R. 61190, October 24, 1979.

the proposed rules in Docket Nos. RM79-54 and RM79-55. In a Request for Further Comments[5], the Commission requested further public comment on both proposed rules, and on the findings set forth in the preliminary EA. In order to obtain the data, views, and arguments of interested parties, the Commission Staff held public hearings in Seattle on November 19, 1979, in New York on November 28, 1979, in Denver on November 30, 1979, and in Washington, D.C. on December 4 and 5, 1979. The Commission also received written comment.

After consideration of the comments, the Commission Staff made available a final draft rule on January 29, 1980. State public utility commissioners were invited to comment on the draft at a public meeting held on February 5, 1980. Representatives of electric utilities were invited to comment at a public meeting held on February 8, 1980. The Commission Staff also made itself available to any other interested parties who wished to comment. All of the comments were considered in the formulation of this final rule.

In the Staff Discussion Paper and the Request for Further Comments, it was stated that any environmental effects attributable to this program would result from the combined effect of these two rulemaking proceedings. As noted previously, the Commission intends to issue final rules in Docket No. RM79-54 in the near future. At that time, the Commission will also make available its final Environmental Assessment.

II. SUMMARY

These rules provide that electric utilities must purchase electric energy and capacity made available by qualifying cogenerators and small power producers at a rate reflecting the cost that the purchasing utility can avoid as a result of obtaining energy and capacity from these sources, rather than generating an equivalent amount of energy itself or purchasing the energy or capacity from other suppliers. To enable potential cogenerators and small power producers to be able to estimate these avoided costs, the rules require electric utilities

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5 44 F.R. 61977, October 29, 1979.

to furnish data concerning present and future costs of energy and capacity on their systems.

These rules also provide that electric utilities must furnish electric energy to qualifying facilities on a nondiscriminatory basis, and at a rate that is just and reasonable and in the public interest; and that they must provide certain types of service which may be requested by qualifying facilities to supplement or back up those facilities' own generation.

The rule exempts all qualifying cogeneration facilities and certain qualifying small power production facilities from certain provisions of the Federal Power Act, from all of the provisions of the Public Utility Holding Company Act of 1935 related to electric utilities, and from State laws regulating electric utility rates and financial organization.

The implementation of these rules is reserved to the State regulatory authorities and nonregulated electric utilities. Within one year of the issuance of the Commission's rules, each State regulatory authority or nonregulated utility must implement these rules. That implementation may be accomplished by the issuance of regulations, on a case-by-case basis, or by any other means reasonably designed to give effect to the Commission's rules.

III. SECTION-BY-SECTION ANALYSIS

SUBPART A—GENERAL PROVISIONS

§ 292.101 *Definitions.*

This section contains definitions applicable to this part of the Commission's rules. Paragraph (a) provides that terms defined in PURPA have the same meaning as they have in PURPA, unless further defined in this part of the Commission's regulations. The definitions in PURPA are found in section 3 of that Act.

Subparagraph (1) defines a qualifying facility as a cogeneration or small power production facility which is a qualifying facility under Subpart B of the Commission's regulations. Those regulations implement section 201 of PURPA, and are the subject of Docket No. RM79-54.

Subparagraph (2) defines "purchase" as the purchase of electric energy or capacity or both from a qualifying facility by an electric utility.

Subparagraph (3) defines "sale" as the sale of electric energy or capacity or both by an electric utility to a qualifying facility.

In the proposed rule, subparagraph (4) defined "system emergency" as a condition on a utility's system "which is likely to result in disruption of service to a significant number of customers or is likely to endanger life or property." In response to comments noting the difficulty in determining what constitutes a "significant number" of customers, the Commission has amended the definition to "a condition on an electric utility's system which is likely to result in imminent significant disruption of service to customers, or is imminently likely to endanger life or property." The emphasis is placed on the significance of the disruption of service, rather than on the number of customers affected.

Subparagraph (5) defines "rate" as any price, rate, charge, or classification made, demanded, observed or received with respect to the sale or purchase of electric energy or capacity, or any rule, regulation, or practice respecting any such rate, charge, or classification, and any contract pertaining to the sale or purchase of electric energy or capacity.

In the proposed rule, subparagraph (6) defined "avoided costs" as the costs to an electric utility of energy or capacity or both which, but for the purchase from a qualifying facility, the electric utility would generate or construct itself or purchase from another source. This definition is derived from the concept of "the incremental cost to the electric utility of alternative electric energy" set forth in section 210(d) of PURPA. It includes both the fixed and the running costs on an electric utility system which can be avoided by obtaining energy or capacity from qualifying facilities.

The costs which an electric utility can avoid by making such purchases generally can be classified as "energy" costs or "capacity" costs. Energy costs are the variable costs associated with the production of electric energy (kilowatt-hours). They represent the cost of fuel, and some operating and main-

tenance expenses. Capacity costs are the costs associated with providing the capability to deliver energy; they consist primarily of the capital costs of facilities.

If, by purchasing electric energy from a qualifying facility, a utility can reduce its energy costs or can avoid purchasing energy from another utility, the rate for a purchase from a qualifying facility is to be based on those energy costs which the utility can thereby avoid. If a qualifying facility offers energy of sufficient reliability and with sufficient legally enforceable guarantees of deliverability to permit the purchasing electric utility to avoid the need to construct a generating unit, to build a smaller, less expensive plant, or to reduce firm power purchases from another utility, then the rates for such a purchase will be based on the avoided capacity and energy costs.

The Commission has added the term "incremental" to modify the costs which an electric utility would avoid as a result of making a purchase from a qualifying facility. Under the principles of economic dispatch, utilities generally turn on last and turn off first their generating units with the highest running cost. At any given time, an economically dispatched utility can avoid operating its highest-cost units as a result of making a purchase from a qualifying facility. The utility's avoided incremental costs (and not average system costs) should be used to calculate avoided costs. With regard to capacity, if a purchase from a qualifying facility permits the utility to avoid the addition of new capacity, then the avoided cost of the new capacity and not the average embedded system cost of capacity should be used.

Many comments noted that the definition of "avoided cost" in the proposed rule failed to link the capacity costs which a utility might avoid as a result of purchasing electric energy or capacity or both from a qualifying facility with the energy costs associated with the new capacity. If the Commission required electric utilities to base their rates for purchases from a qualifying facility on the high capital or capacity cost of a base load unit and, in addition, provided that the rate for the avoided energy should be based on the high energy cost

associated with a peaking unit, the electric utilities' purchased power expenses would exceed the incremental cost of alternative electric energy, contrary to the limitation set forth in the last sentence of section 210(b).

One way of determining the avoided cost is to calculate the total (capacity and energy) costs that would be incurred by a utility to meet a specified demand in comparison to the cost that the utility would incur if it purchased energy or capacity or both from a qualifying facility to meet part of its demand, and supplied its remaining needs from its own facilities. The difference between these two figures would represent the utility's net avoided cost. In this case, the avoided costs are the excess of the total capacity and energy cost of the system developed in accordance with the utility's optimal capacity expansion plan,[6] *excluding* the qualifying facility, over the total capacity and energy cost of the system (before payment to the qualifying facility) developed in accordance with the utility's optimal capacity expansion plan *including* the qualifying facility.[7]

Subparagraph (7) defines "interconnection costs" as the reasonable costs of connection, switching, metering, transmission, distribution, safety provisions and administrative costs incurred by the electric utility directly related to the installation and maintenance of the physical facilities necessary to permit interconnected operations with a qualifying facility, to the extent such costs are in excess of the corresponding costs which the electric utility would have incurred if it had not engaged in interconnected operations, but instead generated an equivalent amount of energy itself or purchased an equivalent amount of electric energy or capacity from other sources. Interconnection

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6 An optimal capacity expansion plan is the schedule for the addition of new generating and transmission facilities which, based on an examination of capital, fuel, operating and maintenance costs, will meet a utility's projected load requirements at the lowest total cost.

7 Throughout the rule and preamble, the phrase "energy or capacity" is used. This phrase is intended to include the capacity and energy costs associated with the capacity, if the purchase involves both energy or capacity.

costs do not include any costs included in the calculation of avoided costs.

The Commission has clarified this definition to include distribution and administrative costs associated with the interconnected operation, in response to comments indicating that the proposed rule was vague in these respects. This definition is designed to provide the State regulatory authorities and nonregulated electric utilities with the flexibility to ensure that all costs which are shown to be reasonably incurred by the electric utility as a result of interconnection with the qualifying facility will be considered as part of the obligation of the qualifying facility under § 292.306. These costs may include, but are not limited to, operating and maintenance expenses, the costs of installation of equipment elsewhere on the utility's system necessitated by the interconnection, and reasonable insurance expenses. However, the Commission does not expect that litigation expenses incurred by the utility involving this section will be considered a legitimate interconnection cost to be borne by the qualifying facility.

Certain interconnection costs may be incurred as a result of sales from a utility to a qualifying facility. The Commission notes that the Joint Explanatory Statement of the Committee of Conference (Conference Report) prohibits the use of "unreasonable rate structure impediments, such as unreasonable hook up charges or other discriminatory practices . . ."[8] This prohibition is reflected in § 292.306(a) of these rules, which provides that interconnection costs must be assessed on a nondiscriminatory basis with respect to other customers with similar load characteristics.

A qualifying facility which is already interconnected with an electric utility for purposes of sales may seek to establish interconnection for the purpose of utility purchases from the qualifying facility. In this case, the qualifying facility may have compensated the utility for its interconnection costs with respect to sales to the qualifying facility, either as part of the utility's demand or energy charges, or through a separate

[8] Conference Report on H.R. 4018, Public Utility Regulatory Policies Act of 1978, H. Rep. No. 1750, 98, 95th Cong., 2d Sess. (1978).

customer charge. If this is the case, the interconnection costs associated with the purchase include only those additional interconnection expenses incurred by the electric utility as a result of the purchase, and do not include any portion of the interconnection costs for which the qualifying facility has already paid through its retail rates.

One comment recommended that the definition be revised to cover "all identifiable costs, including but not limited to, the costs of interconnection . . . resulting from interconnected operation". The Commission rejects this suggestion in order to maintain consistency with its initial determination to separate the utility's avoided costs with regard to purchases from qualifying facilities, from the costs incurred as a result of interconnection with a qualifying facility. Accordingly, legitimate costs not recovered pursuant to this section can be netted out in the calculation of avoided costs.

This definition also incorporates the concept from the proposed rule, as clarified in an erratum notice,[9] that these costs are limited to the net increased interconnection costs imposed on an electric utility compared to those interconnection costs it would have incurred had it generated the energy itself or purchased an equivalent amount of energy or capacity from another source.

This section of the rule contains definitions of "supplementary power", "back-up power", "interruptible power", and "maintenance power" which did not appear in the proposed rule.

Subparagraph (8) defines "supplementary power" as electric energy or capacity, supplied by an electric utility, regularly used by a qualifying facility in addition to that which the facility generates itself.

Subparagraph (9) defines "back-up power" as electric energy or capacity supplied by an electric utility to replace energy ordinarily generated by a facility's own generation equipment during an unscheduled outage of the fa ity.

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9 44 F.R. 63114, November 2, 1979.

Subparagraph (10) defines "interruptible power" as electric energy or capacity supplied by an electric utility subject to interruption by the electric utility under specified conditions.

Subparagraph (11) defines "maintenance power" as electric energy or capacity supplied by an electric utility during scheduled outages of the qualifying facility.

SUBPART C—ARRANGEMENTS BETWEEN ELECTRIC UTILITIES AND QUALIFYING COGENERATION AND SMALL POWER PRODUCTION FACILITIES UNDER SECTION 210 OF THE PUBLIC UTILITY REGULATORY POLICIES ACT OF 1978

§ 292.301 *Scope.*

Section 292.301(a) describes the scope of Subpart C of Part 292 of the Commission's rules. Subpart C applies to sales and purchases of electric energy or capacity between qualifying cogeneration or small power production facilities and electric utilities, and actions related to such sales and purchases. Section 292.301(b)(1) provides that this subpart does not preclude negotiated agreements between qualifying cogenerators or small power producers and electric utilities which differ from rates, or terms or conditions which would otherwise be required under the subpart. Paragraph (b)(2) states that this subpart does not affect the validity of any contract entered into between a qualifying facility and an electric utility for any purchase.[10]

Paragraph (b)(1) reflects the Commission's view that the rate provisions of section 210 of PURPA apply only if a qualifying cogenerator or small power production facility chooses to avail itself of that section. Agreements between an electric utility and a qualifying cogenerator or small power producer for purchases at rates different than rates required by these rules, or under terms or conditions different from those set forth in

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10 The term "purchase" is defined in section 292.101(b).

these rules, do not violate the Commission's rules under section 210 of PURPA. The Commission recognizes that the ability of a qualifying cogenerator or small power producer to negotiate with an electric utility is buttressed by the existence of the rights and protections of these rules.

Some comments stated that paragraph (b)(2) would unfairly penalize cogenerators and small power producers who, prior to the promulgation of these regulations, entered into binding contracts with electric utilities under less favorable terms than might be obtainable under these rules. The Commission interprets its mandate under section 210(a) to prescribe "such rules as it determines necessary to encourage cogeneration and small power production . . . " to mean that the total costs to the utility and the rates to its other customers should not be greater than they would have been had the utility not made the purchase from the qualifying facility or qualifying facilities. That a cogeneration or small power production facility entered into a binding contractual arrangement with an electric utility indicates that it is likely that sufficient incentive existed, and that the further encouragement provided by these rules was not necessary. As a result, the Commission has not revised this provision.

§ 292.302 *Availability of electric utility system cost data.*

As the Commission observed in the Notice of Proposed Rulemaking, in order to be able to evaluate the financial feasibility of a cogeneration or small power production facility, an investor needs to be able to estimate, with reasonable certainty, the expected return on a potential investment before construction of a facility. This return will be determined in part by the price at which the qualifying facility can sell its electric output. Under § 292.304 of these rules, the rate at which a utility must purchase that output is based on the utility's avoided costs, taking into account the factors set forth in paragraph (e) of that section. Section § 292.302 of these rules is intended by the Commission to assist those needing data from which avoided costs can be derived. It requires electric utilities to make available to cogenerators and small power

producers data concerning the present and anticipated future costs of energy and capacity on the utility's system.

In the preamble to the proposed rule, the Commission stated that most electric utilities will have prepared data containing some of this information in compliance with the Commission's rules implementing section 133 of PURPA. Several commenters observed that the marginal cost data required to be provided pursuant to section 133 cannot be directly translated into a rate for purchases. The Commission has clarified paragraph (b) to emphasize that these data are not intended to represent a rate for purchases from qualifying facilities. Rather, these data are to be considered the first step in the determination of such a rate.

The Commission has also revised this section so that the rates for purchases can be more readily calculated from the data produced. The Commission has changed paragraph (b)(3) to provide that a utility shall submit the associated energy cost of each planned unit expressed in kilowatt-hours (kWh) along with the estimated capacity cost of planned capacity additions. This change is intended to ensure that the calculation of avoided costs includes the lower energy costs that might be associated with the new capacity. The Commission points out that the determination of a rate for purchases from a qualifying facility which enables a utility to defer or avoid the addition of a new unit must also reflect the hours of expected use of the deferred or avoided capacity addition.

The coverage under paragraph (a) of this section is the same as that provided pursuant to section 133 of PURPA and the Commission's rules implementing that section.[11] As noted in the Notice of Proposed Rulemaking, section 133 of PURPA applies to each electric utility whose total sales of electric energy for purposes other than resale exceeded 500 million kwh during any calendar year beginning after December 31, 1975, and before the immediately preceding calendar year.

Paragraph (b) provides that each regulated electric utility meeting the requirements of paragraph (a) must furnish to its

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11 44 F.R. 58687, October 11, 1979.

State regulatory authority, and maintain for public inspection, data related to the costs of energy and capacity on the electric utility's system. Each nonregulated electric utility also must maintain such data for public inspection.

In response to comments received, the Commission has extended the date by which these data must be first provided to November 1, 1980, and changed the second date to May 31, 1982, to conform to the dates required by the Commission's regulations implementing section 133 of PURPA. The Commission has added paragraph (d) to allow a State regulatory authority or nonregulated utility to use a different approach than that provided in paragraph (b). As part of that substitute program, a State regulatory authority or nonregulated electric utility could provide that cost data be updated more frequently than every two years.

Subparagraph (1) of paragraph (b) requires each electric utility to provide the estimated avoided cost of energy on its system for various levels of purchases from qualifying facilities. The levels of purchases are to be stated in blocks of not more than 100 megawatts for systems with peak demand of 1000 megawatts or more, and in blocks equivalent to not more than ten percent of system peak demand for sytems less than 1000 megawatts. This information is to be stated on a cents per kilowatt-hour basis, for daily and seasonal peak and off-peak periods, for the current calendar year and for each of the next five years.

Subparagraph (2) of paragraph (b) requires each electric utility to provide its schedule for the addition of capacity, planned purchases of firm energy and capacity, and planned capacity retirements for each of the next ten years.

Subparagraph (3) of paragraph (b) has been revised, as discussed previously, so that the costs of planned capacity additions include the associated energy costs.

The Commission received comment noting that some States have implemented or are planning to implement alternative methods by which electric utilities' system cost data would be made available. In order to prevent the preparation of duplicative data where the alternative method substantially deviates

from the Commission approach, the Commission has added paragraph (d). This paragraph provides that any State regulatory authority or nonregulated electric utility may, after providing public notice in the area served by the utility and after opportunity for public comment, require data different than that which are otherwise required by this section if it determines that avoided costs can be derived from such data. Any State regulatory authority or nonregulated utility shall notify the Commission within 30 days of any determination to substitute data requirements.

If a qualifying facility finds that the alternative requirements do not provide sufficient data from which avoided costs may be derived, the qualifying facility may seek court review of the matter as it can with regard to any other aspect of the State's implementation of this program.

A qualifying facility may wish to sell energy or capacity to an electric utility which is not subject to the reporting requirements of paragraph (b). In that event, paragraph (c) provides that, upon request of a qualifying facility, an electric utility not otherwise covered by paragraph (b) must provide data sufficient to enable the cogenerator or small power producer to estimate the utility's avoided costs. If such utility does not supply the requested data, the qualifying facility may apply to the State regulatory authority which has ratemaking authority over the utility or to this Commission for an order requiring that the information be supplied. The consideration of such applications should take into account the burden imposed on the small utilities.

An electric utility which is legally obligated to obtain all of its requirements for electric energy and capacity from another utility may provide the data provided by its supplying utility and the rates at which it currently purchases such energy and capacity for any period during which this obligation will continue. The wholesale rates may require adjustment in order to reflect properly the avoided costs. This is discussed later in this preamble under § 292.303. In the case of small, nongenerating utilities, the requirements of this section will be considered to have been satisfied if these cost data are readily available from the supplying utility.

Numerous comments mentioned that the proposed rule did not address the issue of validation of the data to be provided pursuant to this section. As a result, the Commission has added paragraph (e) which provides that any data submitted by an electric utility under this section shall be subject to review by its State regulatory authority. Paragraph (e)(2) places the burden of providing support for the data on the utility supplying the data.

§ 292.303 *Electric utility obligations under this subpart.*

Section 210(a) of PURPA provides that the Commission prescribe rules requiring electric utilities to offer to purchase electric energy from qualifying facilities. The Commission interprets this provision to impose on electric utilities an obligation to purchase all electric energy and capacity made available from qualifying facilities with which the electric utility is directly or indirectly interconnected, except during periods described in § 292.304(f) or during system emergencies.

A qualifying facility may seek to have a utility purchase more energy or capacity than the utility requires to meet its total system load. In such a case, while the utility is legally obligated to purchase any energy or capacity provided by a qualifying facility, the purchase rate should only include payment for energy or capacity which the utility can use to meet its total system load. These rules impose no requirement on the purchasing utility to deliver unusable energy or capacity to another utility for subsequent sale.

§ 292.303(a) *Obligation to purchase from qualifying facilities.*

§ 292.303(d) *Transmission to other electric utilities.*

All-Requirement Contracts

Several commenters noted that the obligation to purchase from qualifying facilities under this section might conflict with contractual commitments into which they had entered re-

quiring them to purchase all of their requirements from a wholesale supplier. One commenter noted that, with regard to all-requirements rural electric cooperatives, any impairment of the obligation to obtain all of a cooperative's requirements from a generation and transmission cooperative might affect the financing ability of the generation and transmission cooperative. The Commission observes that, in general, if it permitted such contractual provisions to override the obligation to purchase from qualifying facilities, these contractual devices might be used to hinder the development of cogeneration and small power production. The Commission believes that the mandate of PURPA to encourage cogeneration and small power production requires that obligations to purchase under this provision supersede contractual restrictions on a utility's ability to obtain energy or capacity from a qualifying facility.

The Commission has, however, provided an alternate means by which any electric utility can meet this obligation. Under paragraph (d), if the qualifying facility consents, an all-requirements utility which would otherwise be obligated to purchase energy or capacity from the qualifying facility would be permitted to transmit the energy or capacity to its supplying utility. In most instances, this transaction would actually take the form of the displacement of energy or capacity that would have been provided under the all-requirements obligation. In this case, the supplying utility is deemed to have made the purchase and, as a result, the all-requirements obligation is not affected.

In addition, if compliance with the purchase obligation would impose a special hardship on an all-requirements customer, the Commission may consider waiving such purchase obligation pursuant to the procedures set forth in § 292.403.

Transmission to Other Facilities

There are several circumstances in which a qualifying facility might desire that the electric utility with which it is interconnected not be the purchaser of the qualifying facility's energy and capacity, but would prefer instead that an electric utility

with which the purchasing utility is interconnected make such a purchase. If, for example, the purchasing utility is a non-generating utility, its avoided costs will be the price of bulk purchased power ordinarily based on the average embedded cost of capacity and average energy cost on its supplying utility's system. As a result, the rate to the qualifying facility would be based on those average costs. If, however, the qualifying facility's output were purchased by the supplying utility, its output ordinarily will replace the highest cost energy on the supplying utility's system at that time, and its capacity might enable the supplying utility to avoid the addition of new capacity. Thus, the avoided costs of the supplying utility may be higher than the avoided cost of the non-generating utility.

This would not appear to be the case if the qualifying facility offers to supply capacity and energy in a situation in which the supplying utility is in an excess capacity situation. Since the supplying utility has excess capacity, its avoided costs would include only energy costs. On the other hand, if the avoided cost were based on the wholesale rate to the all-requirements utility, the avoided cost would include the demand charge included in the wholesale rate, which would usually reflect an allocation of a portion of the fixed charges associated with excess capacity.

Use of the unadjusted wholesale rate fails to take into account the effect of reduced revenue to the supplying utility, as a result of the substitute of the qualifying facility's output for energy previously supplied by the supplying utility. As the level of purchase by the all-requirements utility decreases, the supplying utility's fixed costs will have to be allocated over a smaller number of units of output. In effect, the loss in revenue to the supplying utility will cause the demand charges to the supplying utility's customers (including the all-requirements customers interconnected with the qualifying facility) to increase. Under the definition of "avoided costs" in this section, the purchasing utility must be in the same financial position it would have been had it not purchased the qualifying facility's output. As a result, rather than allocating its loss in revenue among all of its customers, in this situation the

supplying utility should assign all of these losses to the all-requirements utility. That utility should, in turn, deduct these losses from its previously calculated avoided costs, and pay the qualifying facility accordingly.

Under these rules, certain small electric utilities are not required to provide system cost data, except upon request of a qualifying facility. If, with the consent of the qualifying facility, a small electric utility chooses to transmit energy from the qualifying facility to a second electric utility, the small utility can avoid the otherwise applicable requirements that it provide the system cost data for the qualifying facility and that it purchase the energy itself. However, the ability to transmit a purchase to another utility is not limited to these smaller systems; it applies to any utility.

Accordingly, paragraph (d) provides that a utility which receives energy or capacity from a qualifying facility may, with the consent of the qualifying facility, transmit such energy to another electric utility. However, if the first facility does not agree to transmit the purchased energy or capacity, it retains the purchase obligation. In addition, if the qualifying facility does not consent to transmission to another utility, the first utility retains the purchase obligation. Any electric utility to which such energy or capacity is delivered must purchase this energy under the obligations set forth in these rules as if the purchase were made directly from the qualifying facility.

One commenter stated that this provision could result in energy being transmitted to a utility which has little or no information regarding the reliability of the qualifying facility. The Commission believes that, prior to these transactions occurring, it will be in the interest of the qualifying facility to inform any utility to which energy or capacity is delivered, of the nature of those deliveries, so that such energy or capacity can be usefully integrated into that utility's power supply.

Several other commenters believed that this provision went beyond the authority of section 210 of PURPA—namely, that the Commission cannot require the first utility to wheel the power nor the second utility to buy the power. First, the Commission notes that this transmission can only occur with

the consent of the utility to which energy or capacity from the qualifying facility is made available. Thus, no utility is forced to wheel. Secondly, section 210 does not limit the obligation to purchase to any particular utility; rather, it is a generally applicable requirement.

Paragraph (d) provides that charges for transmission are not a part of the rate which an electric utility to which energy is transmitted is obligated to pay the qualifying facility. In the case of electric utilities not subject to the jurisdiction of this Commission, these charges should be determined under applicable State law or regulation which may permit agreement between the qualifying facility and any electric utility which transmits energy or capacity with the consent of the qualifying facility. For utilities subject to the Commission's jurisdiction under Part II of the Federal Power Act, these charges will be determined pursuant to Part II.

The electric utility to which the electric energy is transmitted has the obligation to purchase the energy at a rate which reflects the costs that it can avoid as a result of making such a purchase. In cases in which electricity actually travels across the transmitting utility's system, the amount of energy delivered will be less than that transmitted, due to line losses. When this occurs, the rate for purchase can reflect these losses. In other cases, the energy supplied by the qualifying facility will displace energy that would have been supplied by the purchasing utility to the transmitting utility. In those cases, a unit of energy supplied from the qualifying facility may replace a greater amount of energy from the purchasing utility. In that case, the rate for purchase should be increased to reflect the net gain. These provisions are also set forth in paragraph (d).

§ 292.303(b) *Obligation to sell to qualifying facilities.*

Paragraph (b) sets forth the statutory requirement of section 210(a) of PURPA that each electric utility offer to sell electric energy to qualifying facilities. The Commission observed in the Notice of Proposed Rulemaking that State law ordinarily sets out the obligation of an electric utility to provide service to

customers located within its service area. In most instances, therefore, this rule will not impose additional obligations on electric utilities.

It is possible that a qualifying facility located outside the service area of an electric utility might require back-up, maintenance, or other types of power. The Commission believes that the instructions of section 210(a) of PURPA that it issue rules "as it determines necessary to encourage cogeneration and small power production . . ." mandate that it assure that such facilities are able to fulfill their needs for service.

However, the Commission also recognizes that State and local law limits the authority of some electric utilities to construct lines outside of their service area. Accordingly, the Commission requires electric utilities to serve any qualifying facility, and, subject to the restriction contained therein, to interconnect with any such facility as required in paragraph (c). However, an electric utility is only required to construct lines or other facilities to the extent authorized or required by State or local law. As a result, a qualifying facility outside the service area of a utility may be required to build its line into the service area of the utility.

§ 292.303(c) *Obligation to interconnect.*

In the Notice of Proposed Rulemaking, the Commission used the interpretation set forth in the Staff Discussion Paper that the obligation to interconnect with a qualifying facility is subsumed within the requirement of section 210(a) that electric utilities offer to sell electric energy to and purchase electric energy from qualifying facilities. The Commission observed that to hold otherwise would mean that Congress intended to require that qualifying facilities go through the complex procedures simply to gain interconnection, contrary to the mandate of section 210 of PURPA to encourage cogeneration and small power production.

During the comment period, this question was further explored, and it was suggested that the Commission has ample authority under the general mandate of section 210(a) of

PURPA—namely, that it prescribe rules necessary to encourage cogeneration and small power production—to require interconnection.

While these interpretations received substantial support in the comments submitted, they were at the same time criticized on the theory that section 210(e)(3) of PURPA does not provide that a qualifying facility may be exempted from section 210 of the Federal Power Act (added by section 202 of PURPA and providing certain interconnection authority) and that this interconnection section specifically includes qualifying cogenerators and small power producers in its applicability. These commenters contended that since section 210 of the Federal Power Act deals explicitly with the subject of interconnections between qualifying facilities and electric utilities, no other section of that Act can be interpreted as also granting authority on that subject, as such an interpretation would render the express provision "surplusage".

With regard to these criticisms, the Commission observes that this argument might be tenable in the situation in which the section of the legislation which deals explicitly with the subject does not contain an express provision that it is *not* to be considered the exclusive authority on the subject. The Commission notes that section 212 of the Federal Power Act (as added by section 204 of PURPA) sets forth certain determinations that the Commission must make before it can issue an order under either section 210 or 211 of the Federal Power Act.

Section 212(e) states that no provision of section 210 of the Federal Power Act shall be treated "(1) as requiring any person to utilize the authority of such section 210 or 211 in lieu of any other authority of law, or (2) as limiting, impairing, or otherwise affecting any other authority of the Commission under any other provision of law." Thus, the Federal Power Act, as amended, expressly provides that the existence of authority under section 210 of the Federal Power Act to require interconnection is not to be interpreted as excluding any other interconnection authority available under any other law. The Commission emphasizes that the limitation is not

restricted to the Federal Power Act, but rather extends to include other authority of law, such as the authority contained in the Public Utility Regulatory Policies Act of 1978, of which section 210 is a part. Clearly, the existence of this provision refutes the contention that section 210 of the Federal Power Act represents the exclusive method by which interconnection can be obtained. As a result, the comment that the direction contained in section 210(e)(3) of PURPA that no qualifying facility can be exempted from section 210 or 212 of the Federal Power Act is not persuasive.

The Commission finds that to require qualifying facilities to go through the complex procedures set forth in section 210 of the Federal Power Act to gain interconnection would, in most circumstances, significantly frustrate the achievement of the benefits of this program. The Commission does not feel that the legal interpretation set forth in the Staff Discussion Paper and the Notice of Proposed Rulemaking is the exclusive theory by which it may require interconnections under this program without resort to sections 210 and 212 of the Federal Power Act. The interpretation brought out during the comment period—that section 210(a) of PURPA provides a general mandate for the Commission to prescribe rules necessary to encourage cogeneration and small power production—provides, in the Commission's view, sufficient authority to require interconnection. The Commission believes that a basic purpose of section 210 of PURPA is to provide a market for the electricity generated by small power producers and cogenerators. The Commission believes that accomplishment of this purpose would be greatly hindered if it were to require qualifying facilities to utilize section 210 of the Federal Power Act as the exclusive means of obtaining interconnection. It therefore concludes that such a restrictive interpretation of the law is not supportable.

Paragraph (c)(1) thus provides that an electric utility must make any interconnections with a qualifying facility which may be necessary to permit purchases from or sales to the qualifying facility. A State regulatory authority or nonregulated elec-

tric utility must enforce this requirement as part of its implementation of the Commission's rules.

In addition, several commenters contended that, if the obligation to interconnect is required under section 210(a) PURPA, the limitation provided in section 212 of the Federal Power Act would not be available. That limitation provides that an electric utility which complies with an interconnection order under section 210 of the Federal Power Act would not be subject to the jurisdiction of the Federal Energy Regulatory Commission for any purposes other than those specified in the interconnection order.

After consideration of this concern, the Commission has added paragraph (c)(2) to provide that no electric utility is required to interconnect with any qualifying facility, if, solely by reason of purchases or sales over the interconnection, the electric utility would become subject to regulation as a public utility under Part II of the Federal Power Act. This exception is provided because the Commission notes that, in balance, the encouragement of cogeneration and small power production would not be furthered if, by virtue of interconnection with a qualifying facility, a previously nonjurisdictional utility were reluctantly to become subject to federal utility regulation.

§ 292.303(e) *Parallel operation.*

In the Notice of Proposed Rulemaking, the Commission provided that each electric utility must offer to operate in parallel with a qualifying facility, provided that the qualifying facility complies with standards established by the State regulatory authority or nonregulated electric utility with regard to the protection of system reliability pursuant to § 292.308. By operating in parallel, qualifying facilities are enabled to export automatically any electric energy which is not consumed by its own load. The comments submitted have not set forth any convincing reasons for changing the proposed rule. Paragraph (e) thus continues to require each electric utility to offer to operate in parallel with a qualifying facility.

§ 292.304 *Rates for purchases.*

Section 210(b) of PURPA provides that in requiring any electric utility to purchase electric energy from a qualifying facility, the Commission must ensure that the rates for the purchase be just and reasonable to the electric consumers of the purchasing utility, in the public interest, and nondiscriminatory to qualifying facilities, but that they not exceed the incremental costs of alternative electric energy (the costs of energy to the utility, which, but for the purchase, the utility would generate itself or purchase from another source).

Relation to State Programs

The Commission has become aware that several States have enacted legislation requiring electric utilities in that State to purchase the electrical output of facilities which may be qualifying facilities under the Commission's rules at rates which may differ from the rates required under the Commission's rules implementing section 210 of PURPA.

This Commission has set the rate for purchases at a level which it believes appropriate to encourage cogeneration and small power production, as required by section 210 of PURPA. While the rules prescribed under section 210 of PURPA are subject to the statutory parameters, the States are free, under their own authority, to enact laws of regulations providing for rates which would result in even greater encouragement of these technologies. However, State laws or regulations which would provide rates lower than the federal standards would fail to provide the requisite encouragement of these technologies, and must yield to federal law.

If a State program were to provide that electric utilities must purchase power from certain types of facilities, among which are included "qualifying facilities," at a rate higher than that provided by these rules, a qualifying facility might seek to obtain the benefits of that State program. In such a case, however, the higher rates would be based on State authority to establish such rates, and not on the Commission's rules.

A facility which provides energy or capacity to a utility under State authority may nevertheless seek to obtain exemption from the Federal Power Act, the Public Utility Holding Company Act, and State regulation of electric utilities as available under section 210(e) of PURPA. The Commission notes that the States lack the authority to exempt a facility from the Federal Power Act or Public Utility Holding Company Act. The Commission finds no inconsistency in a facility's taking advantage of section 210 in order to obtain one of its benefits, while relying on other authority under which to buy from or sell to a utility.

§ 292.304(a) *Rates for purchases.*

Paragraph (a) sets forth the statutory requirement that rates for purchases be just and reasonable to the electric consumers of the electric utility and in the public interest, and not discriminate against qualifying cogeneration and small power production facilities.

In the proposed rule, the Commission stated that there is a rebuttable presumption that the rate for purchases is acceptable if it reflects the avoided cost resulting from a purchase on the basis of system cost data set forth pursuant to § 292.302(b) or (c). Many of the comments received stated that this section was ambiguous.[12] The Commission has therefore provided that the rate for purchases meets the statutory requirements if it equals avoided costs, and has eliminated the reference to the "rebuttable presumption".

Some comments recommended that, as a matter of policy, this section be revised to provide that a State regulatory authority or nonregulated utility has discretion to establish the relationship between the avoided cost and the rate for purchases. Other commenters contended that the Commission should specify that the rate for purchase must equal the avoided cost resulting from such a purchase. In addition,

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12 The relationship between the utility system cost data and the rate for purchases is discussed under § 292.302 and § 292.304(b).

several suggested that the Commission adopt a "split-the-savings" approach.

It is possible that developers of technologies which may be included as qualifying facilities may produce and make available power to electric facilities even though their cost of producing this power is greater than the utility's avoided costs. In most instances, however, purchases of energy or capacity from qualifying facilities will only occur when the cost to the qualifying cogenerator or small power producer of producing the energy or capacity is lower than the utility's avoided costs. Only if this is the case will payment by the utility of its avoided costs provide economic benefit for the cogenerator or small power producer.

When one electric utility can provide energy more cheaply than could another electric utility, the two utilities will often exchange power on a "split-the-savings" basis. In that type of transaction, the two utilities split the difference between the incremental costs incurred and the incremental costs that the purchasing utility would have incurred had it generated the power itself. Several commenters argued that rates for purchases from qualifying facilities should be based upon this same general principle. The effect of such a pricing mechanism would be to transfer to the utility's ratepayers a portion of the savings represented by the cost differential between the qualifying facility and the purchasing electric utility. Several utilities contend that by so allocating these savings, the Commission would provide an incentive for the electric utility to enter into purchase transactions with qualifying cogeneration and small power production facilities.

These commenters also noted that they had previously engaged in purchases from facilities which might become qualifying facilities under the Commission's rules, and they had paid prices for these purchases based on a "split-the-savings" methodology. These commenters observed that if the Commission's rules now require the payment of full avoided cost for these types of purchases, the purchased power expenses of the electric utility would increase.

Moreover, several utilities commented that, for the forseeable future, they are inextricably tied to the use of oil to produce electricity. They contend that unless they are permitted to purchase energy and capacity from qualifying facilities at a rate somewhere between the qualifying facilities' costs and their own costs, they and their ratepayers will be subject to the continually increasing world price of oil.

Commenters opposing this allocation of savings to parties other than the qualifying facility noted that this section of PURPA is intended to encourage the development of cogeneration and small power production. They noted that in providing for this encouragement, the Commission may not set rates for purchases at a level which exceeds the incremental cost of alternative energy. Therefore, they observed that, under the full avoided cost standard, the utilities' customers are kept whole, and pay the same rates as they would have paid had the utility not purchased energy and capacity from the qualifying facility.

Although use of the full avoided cost standard will not produce any rate savings to the utility's customers, several commenters stated that these ratepayers and the nation as a whole will benefit from the decreased reliance on scarce fossil fuels, such as oil and gas, and the more efficient use of energy.

The Commission notes that, in most instances, if part of the savings from cogeneration and small power production were allocated among the utilities' ratepayers, any rate reductions will be insignificant for any individual customer. On the other hand, if these savings are allocated to the relatively small class of qualifying cogenerators and small power producers, they may provide a significant incentive for a higher growth rate of these technologies.

Another concern with the use of a split-the-savings rate for purchases is that it would require a determination of the costs of production of the qualifying facility. A major portion of this legislation is intended to exempt qualifying facilities from the cost-of-service regulation by which electric utilities traditionally have been regulated. The Conference Report noted that:

> It is not the intention of the Conferees that cogenerators and small power producers become subject . . . to the type of examination that is traditionally given to electric utility rate applications to determine what is the just and reasonable rate that they should receive for their electric power.[13]

Thus, section 210(e) of PURPA provides that the Commission shall exempt qualifying facilities from the Public Utility Holding Company Act, from the Federal Power Act and from State law and regulation respecting utility rates or financial organization, to the extent that the Commission determines that such exemption is necessary to encourage cogeneration or small power production.

Several commenters have contended that a determination of the qualifying facility's costs can be made without the detail required by cost-of-service regulation. However, the Commission believes that the basis for the determination of rates for purchases should be the utility's avoided costs and should not vary on the basis of the costs of the particular qualifying facility.

Several commenters recommended that rather than using a split-the-savings approach, the Commission should set rates for purchases at a fixed percentage of avoided costs. The Commission notes that, in most situations, a qualifying cogenerator or small power producer will only produce energy if its marginal cost of production is less than the price he receives for its output. If some fixed percentage is used, a qualifying facility may cease to produce additional units of energy when its costs exceed the price to be paid by the utility. If this occurs, the utility will be forced to operate generating units which either are less efficient than those which would have been used by the qualifying facility, or which consume fossil fuel rather than the alternative fuel which would have been consumed by the qualifying facility had the price been set at full avoided costs.

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13 Conference Report on H.R. 4018, Public Utility Regulatory Policies Act of 1978, H. Rep. No. 1750, 97, 95th Cong., 2d. Sess. (1978).

§ 292.304(b) *Relationship to avoided costs.*

"New Capacity"

The proposed rule differentiated between "old" and "new" production in connection with simultaneous purchases and sales. The proposed rule required an electric utility to purchase at its avoided cost the total output of a facility, construction of which was commenced after the date of issuance of these rules, even if the utility simultaneously sells energy to the facility at its retail rate. The effect of this proposed rule was to separate the production aspect of a qualifying facility from its consumption function. Under this approach, the electrical output of a facility is viewed independently of its electrical needs. Thus, if a cogeneration facility produces five megawatts, and consumes three megawatts, it is treated the same as another qualifying facility that produces five megawatts, and that is located next to a factory that uses three megawatts.

The Commission continues to believe that permitting simultaneous purchase and sale is necessary and appropriate to encourage cogeneration and small power production. The limitation contained in the proposed rule was intended to prevent a cogenerator or small power producer, which had found it economical to produce power for its own consumption prior to the issuance of these rules, from receiving the economic rent that might result from the purchase of its entire output at a utility's full avoided cost after that date without new investment on the part of the qualifying facility.

The same reasoning applies to any facility which was in existence prior to the enactment of PURPA, whether or not it seeks to purchase and sell simultaneously. That construction of the facility was commenced prior to that date may indicate that appropriate economic returns were available without the further incentives provided by section 210.

The Commission is aware that in some instances, if a previously existing qualifying facility were not permitted to receive full avoided costs for its entire output, it would no

longer have sufficient incentive to continue to produce electric power. The cost of production may have risen so as to render the previous rate insufficient to cover the costs of production, or permit an appropriate return.

Thus, with regard to facilities, construction of which commenced on or after the date of enactment of PURPA (November 9, 1978), the Commission has determined it appropriate to provide that rates for purchases shall equal full avoided costs. For facilities, construction of which commenced before the enactment of PURPA, the Commission will permit the State regulatory authorities and nonregulated electric utilities to establish rates for purchases at full avoided costs, or at a lower rate, if the State regulatory authority or nonregulated electric utility determines that the lower rate will provide sufficient encouragement of cogeneration and small power production. Thus, if a previously existing facility shows that it requires rates for purchases based on full avoided costs to remain viable, or to increase its output, the State regulatory authority or nonregulated electric utility is required to establish such rates. This distinction is intended to reflect the need for further incentives and the reasonable expectations of persons investing in cogeneration or small power production facilities prior to or subsequent to the enactment of this law.

Paragraph (b)(1) defines "new capacity" as any purchase of capacity from a qualifying facility, construction of which was commenced on or after November 9, 1978. Subparagraph (2) provides that for new capacity, utilities must pay a rate which equals their avoided cost.

A utility must therefore purchase all of the output from a qualifying facility. However, as explained above, for any portion of that output which is not "new capacity," the State regulatory authority or nonregulated electric utility, as provided in paragraph (b)(3), may provide for a lower rate, if it determines that the lower rate will provide sufficient incentive for cogeneration.

Paragraph (b)(4) requires electric utilities to pay full avoided costs for purchases from new capacity made available from a

qualifying facility, regardless of whether the electric utility is simultaneously making sales to the qualifying facility.

§ 292.304(c) *Standard rates for purchases.*

The Notice of Proposed Rulemaking required electric utilities on request of a qualifying facility to establish a tariff or other method for establishing rates for purchase from qualifying facilities of 10 kw or less. Upon consideration of the comments received, the Commission has determined that the concept of requiring a standard rate for purchases should be retained. Several comments stated that this requirement could similarly be applied to facilities of up to 100 kw or less.

The Commission is aware that the supply characteristics of a particular facility may vary in value from the average rates set forth in the utility's standard rate required by this paragraph. If the Commission were to require individualized rates, however, the transaction costs associated with administration of the program would likely render the program uneconomic for this size of qualifying facility. As a result, the Commission will require that standardized tariffs be implemented for facilities of 100 kW or less.

In addition, some commenters pointed out that standard tariffs can be used on a technology specific basis, to reflect the supply characteristics of the particular technology. Some commenters also observed that the proposed rule did not require that standard rates for purchases from these small facilities be based on the purchasing utility's avoided cost. This omission might have permitted a utility to pay less than that rate for purchases.

The Commission has accordingly revised paragraph (c) to require each State regulatory authority or nonregulated electric utility to cause to be put into effect standard rates for purchases from qualifying facilities with a design capacity of 100 kilowatts or less. The revised rule requires that standard rates for purchases equal the purchasing utility's avoided cost pursuant to paragraphs (a), (b), and (e).

Several commenters noted that standard rates for purchases can also be usefully applied to larger facilities. The Commission believes that the establishment of standard rates for purchases can significantly encourage cogeneration and small power production, provided that these standard rates accurately reflect the costs that the utility can avoid as a result of such purchases. Accordingly, the Commission has added subparagraph (2) which permits, but does not require, State regulatory authorities and nonregulated electric utilities to put into effect a standard rate for purchases from qualifying facilities with a design capacity greater than 100 kilowatts. These rates must equal avoided cost pursuant to paragraphs (a), (b), and (e).

Many commenters at the Commission's public hearings and in written comments recommended that the Commission should require the establishment of "net energy billing" for small qualifying facilities. Under this billing method, the output from a qualifying facility reverses the electric meter used to measure sales from the electric utility to the qualifying facility. The Commission believes that this billing method may be an appropriate way of approximating avoided cost in some circumstances, but does not believe that this is the only practical or appropriate method to establish rates for small qualifying facilities. The Commission observes that net energy billing is likely to be appropriate when the retail rates are marginal cost-based, time-of-day rates. Accordingly, the Commission will leave to the State regulatory authorities and the nonregulated electric utilities the determination as to whether to institute net energy billing.

Paragraph (c)(3)(i) provides that standard rates for purchase should take into account the factors set forth in paragraph (e). These factors relate to the quality of power from the qualifying facility, and its ability to fit into the purchasing utility's generating mix.

Paragraph (e)(vi) is of particular significance for facilities of 100 kW or less. This paragraph provides that rates for purchase shall take into account "the individual and aggregate value of energy and capacity from qualifying facilities on the electric

utility's system . . .". Several commenters presented persuasive evidence showing that an effective amount of capacity may be provided by dispersed small systems, even in the case where delivery of energy from any particular facility is stochastic. Similarly, qualifying facilities may be able to enter into operating agreements with each other by which they are able to increase the assured availability of capacity to the utility by coordinating scheduled maintenance and providing mutual back-up service. To the extent that this aggregate capacity value can be reasonably estimated, it must be reflected in standard rates for purchases.

Several commenters observed that the patterns of availability of particular energy sources can and should be reflected in standard rates. An example of this phenomenon is the availability of wind and photovoltaic energy on a summer peaking system. If it can be shown that system peak occurs when there is bright sun and no wind, rates for purchase could provide a higher capacity payment for photovoltaic cells than for wind energy conversion systems. For systems peaking on dark windy days, the reverse might be true. Subparagraph (3)(ii) thus provides that standard rates for purchases may differentiate among qualifying facilities on the basis of the supply characteristics of the particular technology.

§§ 292.304(b)(5) and (d) *Legally enforceable obligations.*

Paragraphs (b)(5) and (d) are intended to reconcile the requirement that the rates for purchases equal the utilities' avoided cost with the need for qualifying facilities to be able to enter into contractual commitments based, by necessity, on estimates of future avoided costs. Some of the comments received regarding this section stated that, if the avoided cost of energy at the time it is supplied is less than the price provided in the contract or obligation, the purchasing utility would be required to pay a rate for purchases that would subsidize the qualifying facility at the expense of the utility's other ratepayers. The Commission recognizes this possibility, but is cognizant that in other cases, the required rate will turn

out to be lower than the avoided cost at the time of purchase. The Commission does not believe that the reference in the statute to the incremental cost of alternative energy was intended to require a minute-by-minute evaluation of costs which would be checked against rates established in long term contracts between qualifying facilities and electric utilities.

Many commenters have stressed the need for certainty with regard to return on investment in new technologies. The Commission agrees with these latter arguments, and believes that, in the long run, "overestimations" and "underestimations" of avoided costs will balance out.

Paragraph (b)(5) addresses the situation in which a qualifying facility has entered into a contract with an electric utility, or where the qualifying facility has agreed to obligate itself to deliver at a future date energy and capacity to the electric utility. The import of this section is to ensure that a qualifying facility which has obtained the certainty of an arrangement is not deprived of the benefits of its commitment as a result of changed circumstances. This provision can also work to preserve the bargain entered into by the electric utility; should the actual avoided cost be higher than those contracted for, the electric utility is nevertheless entitled to retain the benefit of its contracted for, or otherwise legally enforceable, lower price for purchases from the qualifying facility. This subparagraph will thus ensure the certainty of rates for purchases from a qualifying facility which enters into a commitment to deliver energy or capacity to a utility.

Paragraph (d)(1) provides that a qualifying facility may provide energy or capacity on an "as available" basis, i.e. without a legal obligation. The proposed rule provided that rates for such purchases should be based on "actual" avoided costs. Many comments noted that basing rates for purchases in such cases on the utility's "actual avoided costs" is misleading and could require retroactive ratemaking. In light of these comments, the Commission has revised the rule to provide that the rates for purchases are to be based on the purchasing utility's avoided costs estimated at the time of delivery.[14]

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14 In addition to the avoided costs of energy, these costs must include the prorated share of the aggregate capacity value of such facilities.

Paragraph (d)(2) permits a qualifying facility to enter into a contract or other legally enforceable obligation to provide energy or capacity over a specified term. Use of the term "legally enforceable obligation" is intended to prevent a utility from circumventing the requirement that provides capacity credit for an eligible qualifying facility merely by refusing to enter into a contract with the qualifying facility.

Many commenters noted the same problems for establishing rates for purchases under subparagraph (2) as in subparagraph (1). The Commission intends that rates for purchases be based, at the option of the qualifying facility, on either the avoided costs at the time of delivery or the avoided costs calculated at the time the obligation is incurred. This change enables a qualifying facility to establish a fixed contract price for its energy and capacity at the outset of its obligation or to receive the avoided costs determined at the time of delivery.

A facility which enters into a long term contract to provide energy or capacity to a utility may wish to receive a greater percentage of the total purchase price during the beginning of the obligation. For example, a level payment schedule from the utility to the qualifying facility may be used to match more closely the schedule of debt service of the facility. So long as the total payment over the duration of the contract term does not exceed the estimated avoided costs, nothing in these rules would prohibit a State regulatory authority or non-regulated electric utility from approving such an arrangement.

§ 292.304(c) *Factors affecting rates for purchases.*

Capacity Value

An issue basic to this paragraph is the question of recognition of the capacity value of qualifying facilities.

In the proposed rule, the Commission adopted the argument set forth in the Staff Discussion Paper that the proper interpretation of section 210(b) of PURPA requires that the rates for purchases include recognition of the capacity value provided by qualifying cogeneration and small power production facilities. The Commission noted that language used in section 210

of PURPA and the Conference Report as well as in the Federal Power Act supports this proposition.

In the proposed rule, the Commission cited the final paragraph of the Conference Report with regard to section 210 of PURPA:

> The conferees expect that the Commission, in judging whether the electric power supplied by the cogenerator or small power producer will replace future power which the utility would otherwise have to generate itself either through existing capacity or additions to capacity or purchase from other sources, will take into account the reliability of the power supplied by the cogenerator or small power producer by reason of any legally enforceable obligation of such cogenerator or small power producer to supply firm power to the utility.[15]

In addition to that citation, the Commission notes that the Conference Report states that:

> In interpreting the term "incremental costs of alternative energy", the conferees expect that the Commission and the States may look beyond the costs of alternative sources which are instantaneously available to the utility.[16]

Several commenters contended that, since section 210(a)(2) of PURPA provides that electric utilities must "purchase electric energy" from qualifying facilities, the rate for such purchases should not include payments for capacity. The Commission observes that the statutory language used in the Federal Power Act uses the term "electric energy" to describe the rates for sales for resale in interstate commerce. Demand or capacity payments are a traditional part of such rates. The term "electric energy" is used throughout the Act to refer both to electric energy and capacity. The Commission does not find any

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15 Conference Report on H.R. 4018, Public Utility Regulatory Policies Act of 1978, H. Rep. No. 1750, 99, 95th Cong., 2d. Sess. (1978).

16 *Id.*, pp. 98-9.

evidence that the term "electric energy" in section 210 of PURPA was intended to refer only to fuel and operating and maintenance expenses, instead of all of the costs associated with the provision of electric service.

In addition, the Commission notes that to interpret this phrase to include only energy would lead to the conclusion that the rates for sales *to* qualifying facilities could only include the energy component of the rate since section 210 also refers to "electric energy" with regard to such sales. It is the Commission's belief that this was not the intended result. This provides an additional reason to interpret the phrase electric energy to include both energy and capacity.

In implementing this statutory standard, it is helpful to review industry practice respecting sales between utilities. Sales of electric power are ordinarily classified as either firm sales, where the seller provides power at the customer's request, or non-firm power sales, where the seller and not the buyer makes the decision whether or not power is to be available. Rates for firm power purchases include payments for the cost of fuel and operating expenses, and also for the fixed costs associated with the construction of generating units needed to provide power at the purchaser's discretion. The degree of certainty of deliverability required to constitute "firm power" can ordinarily be obtained only if a utility has several generating units and adequate reserve capacity. The capacity payment, or demand charge, will reflect the cost of the utility's generating units.

In contrast, the ability to provide electric power at the selling utility's discretion imposes no requirement that the seller construct or reserve capacity. In order to provide power to customers at the seller's discretion, the selling utility need only charge for the cost of operating its generating units and administration. These costs, called "energy" costs, ordinarily are the ones associated with non-firm sales of power.

Purchases of power from qualifying facilities will fall somewhere on the continuum between these two types of electric service. Thus, for example, wind machines that furnish power only when wind velocity exceeds twelve miles per hour may be so uncertain in availability of output that they would only

permit a utility to avoid generating an equivalent amount of energy. In that situation, the utility must continue to provide capacity that is available to meet the needs of its customers. Since there are no avoided capacity costs, rates for such sporadic purchases should thus be based on the utility system's avoided incremental cost of energy. On the other hand, testimony at the Commission's public hearings indicated that effective amounts of firm capacity exist for dispersed wind systems, even though each machine, considered separately, could not provide capacity value. The aggregate capacity value of such facilities must be considered in the calculation of rates for purchases, and the payment distributed to the class providing the capacity.

Some technologies, such as photovoltaic cells, although subject to some uncertainty in power output, have the general advantage of providing their maximum power coincident with the system peak when used on a summer peaking system. The value of such power is greater to the utility than power delivered during off-peak periods. Since the need for capacity is based, in part, on system peaks, the qualifying facility's coincidence with the system peak should be reflected in the allowance of some capacity value and an energy component that reflects the avoided energy costs at the time of the peak.

A facility burning municipal waste or biomass may be able to operate more predictably and reliably than solar or wind systems. It can schedule its outages during times when demand on the utility's system is low. If such a unit demonstrates a degree of reliability that would permit the utility to defer or avoid construction of a generating unit or the purchase of firm power from another utility, then the rate for such a purchase should be based on the avoidance of both energy and capacity costs.

In order to defer or cancel the construction of new generating units, a utility must obtain a commitment from a qualifying facility that provides contractual or other legally enforceable assurances that capacity from alternative sources will be available sufficiently ahead of the date on which the utility would otherwise have to commit itself to the construction or purchase of new capacity. If a qualifying facility provides such

assurances, it is entitled to receive rates based on the capacity costs that the utility can avoid as a result of its obtaining capacity from the qualifying facility.

Other comments with regard to the requirement to include capacity payments in avoided costs generally track those set forth in the Staff Discussion Paper and the proposed rule. The thrust of these comments is that, in order to receive credit for capacity and to comply with the requirement that rates for purchases not exceed the incremental cost of alternative energy, capacity payments can only be required when the availability of capacity from a qualifying facility or facilities actually permits the purchasing utility to reduce its need to provide capacity by deferring the construction of new plant or commitments to firm power purchase contracts. In the proposed rule, the Commission stated that if a qualifying facility offers energy of sufficient reliability and with sufficient legally enforceable guarantees of deliverability to permit the purchasing electric utility to avoid the need to construct a generating plant, to enable it to build a smaller, less expensive plant, or to purchase less firm power from another utility than it would otherwise have purchased, then the rates for purchases from the qualifying facility must include the avoided capacity and energy costs. As indicated by the preceding discussion, the Commission continues to believe that these principles are valid and appropriate, and that they properly fulfill the mandate of the statute.

The Commission also continues to believe, as stated in the proposed rule, that this rulemaking represents an effort to evolve concepts in a newly developing area within certain statutory constraints. The Commission recognizes that the translation of the principle of avoided capacity costs from theory into practice is an extremely difficult exercise, and is one which, by definition, is based on estimation and forecasting of future occurrences. Accordingly, the Commission supports the recommendation made in the Staff Discussion Paper that it should leave to the States and nonregulated utilities "flexibility for experimentation and accommodation of special circumstances" with regard to implementation of rates for

purchases. Therefore, to the extent that a method of calculating the value of capacity from qualifying facilities reasonably accounts for the utility's avoided costs, and does not fail to provide the required encouragement of cogeneration and small power production, it will be considered as satisfactorily implementing the Commission's rules.

§ 292.304(e) *Factors affecting rates for purchases.*

As noted previously, several commenters observed that the utility system cost data required under § 292.302 cannot be directly applied to rates for purchase. The Commission acknowledges this point and, as discussed previously, has provided that these data are to be used as a starting point for the calculation of an appropriate rate for purchases equal to the utility's avoided cost. Accordingly, the Commission has removed the reference to the utility system cost data from the definition of rates for purchases, and has inserted the reference to these data in paragraph (e), as one factor to be considered in calculating rates for purchases. Subparagraph (1) states that these data shall, to the extent practicable, be taken into account in the calculation of a rate for purchases.

Subparagraph (2) deals with the availability of capacity from a qualifying facility during system daily and seasonal peak periods. If a qualifying facility can provide energy to a utility during peak periods when the electric utility is running its most expensive generating units, this energy has a higher value to the utility than energy supplied during off-peak periods, during which only units with lower running costs are operating.

The preamble to the proposed rule provided that, to the extent that metering equipment is available, the State regulatory authority or nonregulated electric utility should take into account the time or season in which the purchase from the qualifying facility occurs. Several commenters interpreted this statement as implying that, by refusing to install metering equipment, an electric utility could avoid the obligation to consider the time at which purchases occur. This is not the intent of this provision. Clearly, the more precisely the time of

purchase is recorded the more exact the calculation of the avoided costs, and thus the rate for purchases, can be. Rather than specifying that exact time-of-day or seasonal rates for purchases are required, however, the Commission believes that the selection of a methodology is best left to the State regulatory authorities and nonregulated electric utilities charged with the implementation of these provisions.

Clauses (i) through (v) concern various aspects of the reliability of a qualifying facility. When an electric utility provides power from its own generating units or from those of another electric utility, it normally controls the production of such power from a central location. The ability to so control power production enhances a utility's ability to respond to changes in demand, and thereby enhances the value of that power to the utility. A qualifying facility may be able to enter into an arrangement with the utility which gives the utility the advantage of dispatching the facility. By so doing, it increases its value to the utility. Conversely, if a utility cannot dispatch a qualifying facility, that facility may be of less value to the utility.

Clause (ii) refers to the expected or demonstrated reliability of a qualifying facility. A utility cannot avoid the construction or purchase of capacity if it is likely that the qualifying facility which would claim to replace such capacity may go out of service during the period when the utility needs its power to meet system demand. Based on the estimated or demonstrated reliability of a qualifying facility, the rate for purchases from a qualifying facility should be adjusted to reflect its value to the utility.

Clause (iii) refers to the length of time during which the qualifying facility has contractually or otherwise guaranteed that it will supply energy or capacity to the electric utility. A utility-owned generating unit normally will supply power for the life of the plant, or until it is replaced by more efficient capacity. In contrast, a cogeneration or small power production unit might cease to produce power as a result of changes in the industry or in the industrial processes utilized. Accordingly, the value of the service from the qualifying facility to the

electric utility may be affected by the degree to which the qualifying facility ensures by contract or other legally enforceable obligation that it will continue to provide power. Included in this determination, among other factors, are the term of the commitment, the requirement for notice prior to termination of the commitment, and any penalty provisions for breach of the obligation.

In order to provide capacity value to an electric utility a qualifying facility need not necessarily agree to provide power for the life of the plant. A utility's generation expansion plans often include purchases of firm power from other utilities in years immediately preceding the addition of a major generation unit. If a qualifying facility contracts to deliver power, for example, for a one year period, it may enable the purchasing utility to avoid entering into a bulk power purchase arrangement with another utility. The rate for such a purchase should thus be based on the price at which such power is purchased, or can be expected to be purchased, based upon bona fide offers from another utility.

Clause (iv) addresses periods during which a qualifying facility is unable to provide power. Electric utilities schedule maintenance outages for their own generating units during periods when demand is low. If a qualifying facility can similarly schedule its maintenance outages during periods of low demand, or during periods in which a utility's own capacity will be adequate to handle existing demand, it will enable the utility to avoid the expenses associated with providing an equivalent amount of capacity. These savings should be reflected in the rate for purchases.

Clause (v) refers to a qualifying facility's ability and willingness to provide capacity and energy during system emergencies. Section 292.307 of these regulations concerns the provision of electric service during system emergencies. It provides that, to the extent that a qualifying facility is willing to forego its own use of energy during system emergencies and provide power to a utility's system, the rate for purchases from the qualifying facility should reflect the value of that service. Small power production and cogeneration facilities could provide signifi-

cant back-up capability to electric systems during emergencies. One benefit of the encouragement of interconnected cogeneration and small power production may be to increase overall system reliability during such emergency conditions. Any such benefit should be reflected in the rate for purchases from such qualifying facilities.

Another related factor which affects the capacity value of a qualifying facility is its ability to separate its load from its generation during system emergencies. During such emergencies an electric utility may institute load shedding procedures which may, among other things, require that industrial customers or other large loads stop receiving power. As a result, to provide optimal benefit to a utility in an emergency situation, a qualifying facility might be required to continue operation as a generating plant, while simultaneously ceasing operation as a load on the utility's system. To the extent that a facility is unable to separate its load from its generation, its value to the purchasing utility decreases during system emergencies. To reflect such a possibility, clause (v) provides that the purchasing utility may consider the qualifying facility's ability to separate its load from its generation during system emergencies in determining the value of the qualifying facility to the electric utility.

Clause (vi) refers to the aggregate capability of capacity from qualifying facilities to displace planned utility capacity. In some instances, the small amounts of capacity provided from qualifying facilities taken individually might not enable a purchasing utility to defer or avoid scheduled capacity additions. The aggregate capability of such purchases may, however, be sufficient to permit the deferral or avoidance of a capacity addition. Moreover, while an individual qualifying facility may not provide the equivalent of firm power to the electric utility, the diversity of these facilities may collectively comprise the equivalent of capacity.

Clause (vii) refers to the fact that the lead time associated with the addition of capacity from qualifying facilities may be less than the lead time that would have been required if the purchasing utility had constructed its own generating unit.

Such reduced lead time might produce savings in the utility's total power production costs, by permitting utilities to avoid the "lumpiness," and temporary excess capacity associated therewith, which normally occur when utilities bring on line large generating units. In addition, reduced lead time provides the utility with greater flexibility with which it can accommodate changes in forecasts of peak demand.

Subparagraph (3) concerns the relationship of energy or capacity from a qualifying facility to the purchasing electric utility's need for such energy or capacity. If an electric utility has sufficient capacity to meet its demand, and is not planning to add any new capacity to its system, then the availability of capacity from qualifying facilities will not immediately enable the utility to avoid any capacity costs. However, an electric utility system with excess capacity may nevertheless plan to add new, more efficient capacity to its system. If purchases from qualifying facilities enable a utility to defer or avoid these new planned capacity additions, the rate for such purchases should reflect the avoided costs of these additions. However, as noted by several commenters, the deferral or avoidance of such a unit will also prevent the substitution of the lower energy costs that would have accompanied the new capacity. As a result, the price for the purchase of energy and capacity should reflect these lower avoided energy costs that the utility would have incurred had the new capacity been added.

This is not to say that electric utilities which have excess capacity need not make purchases from qualifying facilities; qualifying facilities may obtain payment based on the avoided energy costs on a purchasing utility's system. Many utility systems with excess capacity have intermediate or peaking units which use high-cost fossil fuel. As a result, during peak hours, the energy costs on the systems are high, and thus the rate to a qualifying utility from which the electric utility purchases energy should similarly be high.

Subparagraph (4) addresses the costs or savings resulting from line losses. An appropriate rate for purchases from a qualifying facility should reflect the cost savings actually accruing to the electric utility. If energy produced from a qualify-

ing facility undergoes line losses such that the delivered power is not equivalent to the power that would have been delivered from the source of power it replaces, then the qualifying facility should not be reimbursed for the difference in losses. If the load served by the qualifying facility is closer to the qualifying facility than it is to the utility, it is possible that there may be net savings resulting from reduced line losses. In such cases, the rates should be adjusted upwards.

§ 292.303(f) *Periods during which purchase are not required.*

The proposed rule provided that an electric utility will not be required to purchase energy and capacity from qualifying facilities during periods in which such purchases will result in net increased operating costs to the electric utility. This section was intended to deal with a certain condition which can occur during light loading periods. If a utility operating only base load units during these periods were forced to cut back output from the units in order to accommodate purchases from qualifying facilities, these base load units might not be able to increase their output level rapidly when the system demand later increased. As a result, the utility would be required to utilize less efficient, higher cost units with faster start-up to meet the demand that would have been supplied by the less expensive base load unit had it been permitted to operate at a constant output.

The result of such a transaction would be that rather than avoiding costs as a result of the purchase from a qualifying facility, the purchasing electric utility would incur greater costs than it would have had it not purchased energy or capacity from the qualifying facility. A strict application of the avoided cost principle set forth in this section would assess these additional costs as negative avoided costs which must be reimbursed by the qualifying facility. In order to avoid the anomalous result of forcing a qualifying utility to pay an electric utility for purchasing its output, the Commission proposed that an electric utility be required to identify periods during which this situation would occur, so that the qualifying facility could cease delivery of electricity during those periods.

Many of the comments received reflected a suspicion that electric utilities would abuse this paragraph to circumvent their obligation to purchase from qualifying facilities. In order to minimize that possibility, the Commission has revised this paragraph to provide that any electric utility which seeks to cease purchasing from qualifying facilities must notify each affected qualifying facility prior to the occurrence of such a period, in time for the qualifying facility to cease delivery of energy or capacity to the electric utility. This notification can be accomplished in any reasonable manner determined by the State regulatory authority. Any claim by an electric utility that such a light loading period will occur or has occurred is subject to such verification by its State regulatory authority as the State authority determines necessary or appropriate either before or after its occurrence. Moreover, any electric utility which fails to provide adequate notice or which incorrectly identifies such a period will be required to reimburse the qualifying facility for energy or capacity supplied as if such a light loading period had not occurred.

The section has also been modified to clarify that such periods must be due to operational circumstances.

The Commission does not intend that this paragraph override contractual or other legally enforceable obligations incurred by the electric utility to purchase from a qualifying facility. In such arrangements, the established rate is based on the recognition that the value of the purchase will vary with the changes in the utility's operating costs. These variations ordinarily are taken into account, and the resulting rate represents the average value of the purchase over the duration of the obligation. The occurrence of such periods may similarly be taken into account in determining rates for purchases.

Tax Issues

The Conference Report states that:

> . . . the examination of the level of rates which should apply to the purchase by the utility of the cogenerator's or the small power producer's power should not be burdened

by the same examination as are utility rate applications to determine what is the just and reasonable rate that they should receive for their electric power.[17]

The Commission notes that section 301(b)(2) of the Energy Tax Act of 1978[18] makes certain energy property eligible for increased business investment tax credit. Some of this property is commonly used in cogeneration and small power production. However, section 301(b)(2)(B) excludes from such eligibility property "which is public utility property (within the meaning of section 46(f)(5) of the Internal Revenue Code of 1954)."[19] As a result, if the property of a qualifying facility which was otherwise eligible for the credit were to be classified as public utility property under section 46(f)(5) of the Internal Revenue Code, it would not be eligible for the increased investment tax credit.

The Commission notes that the Treasury Department's regulations provide that the definition of "public utility property" does not include property used in the business of the furnishing or sale of electric energy if the rates are not subject to regulation that fixes a rate of return on investment.[20] On this basis, the Commission believes that property of a qualifying facility that would otherwise be eligible for the energy tax credit would not be excluded from that eligibility under the public utility property exclusion.

First, this Commission is exempting property of qualifying facilities from regulation under Part II of the Federal Power Act, and from similar State and local laws and regulatory programs. Secondly, the Commission observes that the rates a qualifying facility will receive for sales of power to utilities are

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17 Conference Report on H.R. 4018, Public Utility Regulatory Policies Act of 1978, H. Rep. No. 1750, 98, 95th Cong., 2d Sess. (1978).

18 Pub. L. No. 95-618, 26 U.S.C. §§ 46, 48, November 9, 1978.

19 26 U.S.C. § 48(e)(3)(b).

20 Treasury Reg. § 146-3(g)(2), T.D. 7602 (March 23, 1979).

not based on a regulatory scheme which fixes a rate of return on investment of the qualifying facility.

As a result, the Commission believes that energy property of qualifying facilities should not be barred from eligibility for the tax credit by reason of the public utility property exclusion. The Commission wishes to express its opinion on this matter in an effort to further encourage cogeneration and small power production by means of this rulemaking process.

§ 292.305 *Rates for sales.*

Section 210(c) of PURPA provides that the rules requiring utilities to sell electric energy to qualifying facilities shall ensure that the rates for such sales are just and reasonable, in the public interest, and nondiscriminatory with respect to qualifying cogenerators or small power producers. This section contemplates formulation of rates on the basis of traditional ratemaking (*i.e.,* cost-of-service) concepts.

Paragraph (a) expresses the statutory requirement that such rates be just and reasonable and in the public interest. Paragraph (a) also provides that rates for sales from electric utilities to qualifying facilities not be discriminatory against such facilities in comparison to rates to other customers served by the electric utility.

A qualifying facility is entitled to purchase back-up or standby power at a nondiscriminatory rate which reflects the probability that the qualifying facility will or will not contribute to the need for and the use of utility capacity. Thus, where the utility must reserve capacity to provide service to a qualifying facility, the costs associated with that reservation are properly recoverable from the qualifying facility, if the utility would similarly assess these costs to non-generating customers.

In the proposed rule, paragraph (b) required electric utilities to provide energy and capacity and other services to any qualifying facility at a rate at least as favorable as would be provided to a customer who does not have his own generation. The comments received concerning this paragraph noted that this provision might be interpreted as requiring an electric

utility to provide service to a qualifying facility at its most favorable rate, even if the qualifying facility would not be eligible for such a rate if it did not have its own generation. It is not the Commission's intention that, for example, an industrial cogenerator receive service at a rate applicable to residential customers; rather, such a customer should be charged at a rate applicable to a non-generating industrial customer unless the electric utility shows that a different rate is justified on the basis of sufficient load or other cost-related data. Accordingly, this section now provides that for qualifying facilities which do not simultaneously sell and purchase from the electric utility, the rate for sales shall be the rate that would be charged to the class to which the qualifying facility would be assigned if it did not have its own generation.

Subparagraph (2) provides that if, on the basis of accurate data and consistent system-wide costing principles, the utility demonstrates that the rate that would be charged to a comparable customer without its own generation is not appropriate, the utility may base its rates for sales upon those data and principles. The utility may only charge such rates on a nondiscriminatory basis, however, so that a cogenerator will not be singled out to lose any interclass or intraclass subsidies to which it might have been entitled had it not generated part of its electric energy needs itself.

In situations where a qualifying facility simultaneously sells its output to an electric utility and purchases its requirements from that electric utility, as a bookkeeping matter, the facility's electrical output will not serve its own load, but rather will be supplied to the grid. As a result, the facility's electric load is likely to have the same characteristics as the load of other non-generating customers of the utility. If the utility does not provide data showing otherwise, the appropriate rate for sales to such a facility is the rate that would be charged to a comparable customer without its own generation.

Paragraph (b)(2) of the rule sets forth certain types of service which electric utilities are required to provide qualifying facilities upon request of the facility. These types of service are supplementary power, back-up power, interruptible power and

maintenance power. In response to comments, these terms are defined in the text of the rules, as well as in this preamble.

Back-up or maintenance service provided by an electric utility replaces energy or capacity which a qualifying faciluty [sic] ordinarily supplies to itself. These rules authorize certain facilities to purchase and sell simultaneously. The amount of energy or capacity provided by an electric utility to meet the load of a facility which simultaneously purchases and sells will vary only in accordance with changes in the facility's load; interruptions in the facility's generation will be manifested as variations in purchases from the facility. In such a case, sales to the qualifying facility will not be back-up or maintenance service, but will be similar to the full-requirements service that would be provided if the facility were a non-generating customer.

Supplementary power is electric energy or capacity used by a facility in addition to that which it ordinarily generates on its own. Thus, a cogeneration facility with a capacity of ten megawatts might require five more megawatts from a utility on a continuing basis to meet its electric load of fifteen megawatts. The five megawatts supplied by the electric utility would normally be provided as supplementary power.

Back-up power is electric energy or capacity available to replace energy generated by a facility's own generation equipment during an unscheduled outage. In the example provided above, a cogeneration facility might contract with an electric utility for the utility to have available ten megawatts, should the cogenerator's units experience an outage.

Maintenance power is electric energy or capacity supplied during scheduled outages of the qualifying facility. By pre-arrangement, a utility can agree to provide such energy during periods when the utility's other load is low, thereby avoiding the imposition of large demands on the utility during peak periods.

Interruptible power is electric energy or capacity supplied to a qualifying facility subject to interruption by the electric utility under specified conditions. Many utilities have utilized interruptible service to avoid expensive investment in new

capacity that would otherwise be necessary to assure adequate reserves at time of peak demand. Under this approach utilities assure the adequacy of reserves by arranging to reduce peak demand, rather than by adding capacity. Interruptible service is therefore normally provided at a lower rate than non-interruptible service.

During the Commission's public hearings on this rulemaking, one commenter stated that utilities which have excess capacity do not save any costs by providing interruptible service. The commenter contended that the Commission should not require a utility with excess capacity to offer interruptible service. If a utility is not adding capacity (whether by construction or purchase) to meet anticipated increases in peak demand, the rates charged for interruptible service might appropriately be the same as for non-interruptible services.

The Commission believes that these matters involving the provision of interruptible rates are best handled through the pricing mechanism. However, if as discussed above, interruptible customers provide no savings to the electric utility, the rate for interruptible service need not be lower than the rate for firm service. In such a case, the Commission would consider granting a waiver from this paragraph, under the provisions of § 292.403.

Some comments noted that certain electric utilities do not have any generating capacity, and to require the services listed in subparagraph (1) might place an undue burden on the electric utility. In light of these comments, the State regulatory authorities or the Commission, as the case may be, will allow a waiver of these requirements upon a finding after a showing by the utility to the State regulatory authority or Commission, as the case may be, that provision of these services will impair the utility's ability to render adequate service to its customers or place an undue burden on the electric utility. Notice must be given in the area served by the electric utility, opportunity for public comment must be provided, and an application must be submitted to the State regulatory authority with respect to any electric utility over which it has ratemaking authority or the Commission with respect to any nonregulated electric utility.

Paragraph (c)(1) provides that rates for sales of back-up or maintenance power shall not be based, without factual data, on the assumption that forced outages or other reductions in output by each qualifying facility on an electric utility's system will occur either simultaneously or during the system peak. Like other customers, qualifying facilities may well have intra-class diversity. In addition, because of the variations in size and load requirements among various types of qualifying facilities, such facilities may well have interclass diversity.

The effect of such diversity is that an electric utility supplying back-up or maintenance power to qualifying facilities will not have to plan for reserve capacity to serve such facilities on the assumption that every facility will use power at the same moment. The Commission believes that probabilistic analyses of the demand of qualifying facilities will show that a utility will probably not need to reserve capacity on a one-to-one basis to meet back-up requirements. Paragraph (c)(1) prohibits utilities from basing rates on the assumption that qualifying facilities will impose demands simultaneously and at system peak unless supported by factual data.

The rule provides that utilities may refute these assumptions on the basis of factual data. These data need not be in the form of empirical load data. It might be the case that within certain geographic areas, weather data and performance data would constitute a sufficient basis to refute the assumption relating to the coincidence of the demands imposed, for example, by windmills or photovoltaics, with respect to their need for back-up power.

Paragraph (c)(2) provides that rates for sales shall take into account the extent to which a qualifying facility can usefully coordinate periods of scheduled maintenance with an electric utility. If a qualifying facility stays on line when the utility will need its capacity, and schedules maintenance when the utility's other units are operative, the qualifying facility is more valuable to the utility, as it can reduce its capacity requirements.

§ 292.306 *Interconnection costs.*

Paragraph (a) states that each qualifying facility must reimburse any electric utility which purchases capacity or energy from the qualifying facility for any interconnection costs, on a nondiscriminatory basis with respect to other customers with similar load characteristics. The Commission finds merit in those comments which suggested that the basis of comparison for nondiscriminatory practices in the proposed rule to "any other customer" was too broad, and that the correct reference for nondiscrimination is the practice of the utility in relation to customers in the same class who do not generate electricity. As noted previously, the interconnection costs of a facility which is already interconnected with the utility for purposes of sales are limited to any additional expenses incurred by the utility to permit purchases.

Several commenters expressed their concern that some protection should be provided to qualifying facilities from potential harassment by utilities in the form of requiring unnecessary safety equipment. As discussed above, the State regulatory authorities (with respect to electric utilities over which they have ratemaking authority) and nonregulated electric utilities have the responsibility and authority to ensure that the interconnection requirements are reasonable, and that associated costs are legitimately incurred.

For qualifying facilities with a design capacity of 100 kW or less, the Commission noted that interconnection costs could be assessed on a class basis, and the standard rates for purchases established for classes of facilities of this size pursuant to § 292.304(c)(1) might incorporate these costs. State regulatory authorities (with respect to electric utilities over which they have ratemaking authority) or nonregulated electric utilities may also determine interconnection costs for qualifying facilities with a design capacity of more than 100 kW on either a class average of individual basis.

Numerous comments raised the point that the proposed rule did not address the manner in which electric utilities would be reimbursed. Potential owners and developers of qualifying

facilities recommended that the costs be amortized on a reasonable basis, because paying a large lump sum payment would be a considerable obstacle to the program. Electric utilities generally preferred payment up front, although several commenters indicated that amortization might be acceptable for credit-worthy facilities. The Commission believes that the manner of reimbursements (which may include amortization over a reasonable period of time) is best left to the State regulatory authorities and nonregulated utilities. In the determination of any standard rates for purchases established pursuant to § 292.304(c)(i), if the State approves some manner of amortization, it might consider assignment of uncollected interconnection costs to the class for which the rate is established.

§ 292.307 *System emergencies.*

Paragraph (a) provides that, except as provided under section 202(c) of the Federal Power Act, no qualifying facility shall be compelled to provide energy or capacity to the electric utility during an emergency beyond the extent provided by agreement between the qualifying facility and the utility.

The Commission finds that a qualifying facility should not be required to make available all of its generation to the utility during a system emergency. Such a requirement might interrupt industrial processes with resulting damage to equipment and manufactured goods. Many industries install their own generating equipment in order to ensure that even during a system emergency, their supply of power is not interrupted. To put in jeopardy the availability of power to a qualifying facility during a system emergency because of the facility's ability to provide power to the system during non-emergency periods would result in the discouragement of interconnected operation and a resultant discouragement of cogeneration and small power production. The Commission therefore provides that the qualifying facility's obligation to provide energy and capacity in emergencies be established through contract.

In order to receive full credit for capacity, a qualifying facility must offer energy and capacity during system emergen-

cies to the same extent that it has agreed to provide energy and capacity during non-emergency situations. For example, a 30 megawatt cogenerator may require 20 megawatts for its own industrial purposes, and thus may contract to provide 10 megawatts of capacity to the purchasing utility. During an emergency, the cogenerator must provide the 10 megawatts contracted for to the utility; it need not disrupt its industrial processes by supplying its full capability of 30 megawatts. Of course, if it should so desire, a cogenerator could contractually agree to supply the full 30 megawatts during system emergencies. The availability of such additional back-up capacity should increase utility system reliability, and should be accounted for in the utility's rates for purchases from the cogenerator.

Paragraph (b) provides that an electric utility may discontinue purchases from a qualifying facility during a system emergency if such purchases would contribute to the emergency. In addition, during system emergencies, a qualifying facility must be treated on a nondiscriminatory basis in any load shedding program—*i.e.*, on the same basis that other customers of a similar class with similar load characteristics are treated with regard to interruption of service.

Credit for capacity (as noted in § 292.304(e)(2)(v)) will also take into account the ability of the qualifying facility to separate its load and generation during system emergencies. However, the qualifying facility may well be eligible for some capacity credit even if it cannot separate its load and generation.

§ 292.308 *Standards for operating reliability.*

Section 210(a) of PURPA states that the rules requiring electric utilities to buy from and sell to qualifying facilities shall include provisions respecting minimum reliability of qualifying facilities (including reliability of such facilities during emergencies) and rules respecting reliability of electric utilities during emergencies. The Commission believes that the reliability of qualifying facilities can be accounted for through price;

namely, the less reliable a qualifying facility might be, the less it should be entitled to receive for purchases from it by the utility.

As a result, the Commission has not included specific standards relating to the reliability in the sense of the ability of qualifying facilities to provide energy or capacity.

The Commission has determined that safety equipment exists which can ensure that qualifying facilities do not energize utility lines during utility outages. This section accordingly provides that each State regulatory authority or nonregulated electric utility may establish standards for interconnected operation between electric utilities and qualifying facilities. These standards may be recommended by any utility, any qualifying facility, or any other person. These standards must be accompanied by a statement showing the need for the standard on the basis of system safety and operating requirements.

SUBPART D—IMPLEMENTATION

Summary of this Subpart

Rules in this subpart are intended to carry out the responsibility of the Commission to encourage cogeneration and small power production by clarifying the nature of the obligation to implement the Commission's rules under section 210.

These rules afford the State regulatory authorities and nonregulated electric utilities great latitude in determining the manner of implementation of the Commission's rules, provided that the manner chosen is reasonably designed to implement the requirements of Subpart C. The Commission recognizes that many States and individual nonregulated electric utilities have ongoing programs to encourage small power production and cogeneration. The Commission also recognizes that economic and regulatory circumstances vary from State to State and utility to utility. It is within this context—in recognition of the work already begun and of the variety of local conditions—that the Commission promulgates its regulations requiring implementation of rules issued under section 210.

Because of the Commission's desire not to create unnecessary burdens at the State level, these rules provide a procedure whereby a State regulatory authority or nonregulated electric utility may apply to the Commission for a waiver if it can demonstrate that compliance with certain requirements of Subpart C is not necessary to encourage cogeneration or small power production and is not otherwise required under section 210.

Several commenters expressed their concern that State regulatory authorities would not be able adequately to implement the Commission's rules, and therefore recommended that the Commission issue specific rules which the State regulatory authorities would adopt without change. The Commission does not find this proposal to be appropriate at this time, and believes that providing an opportunity for experimentation by the States is more conducive to development of these difficult rate principles.

Implementation

Section 210(f) of PURPA requires that within one year after the date that this Commission prescribes its rules under subsection (a), and within one year of the date any of these rules is revised, each State regulatory authority and each nonregulated electric utility, after notice and opportunity for hearing, must implement the rules or revisions thereof, as the case may be.

The obligation to implement section 210 rules is a continuing obligation which begins within one year after promulgation of such rules. The requirement to implement may be fulfilled either (1) through the enactment of laws or regulations at the State level, (2) by application on a case-by-case basis by the State regulatory authority, or nonregulated utility, of the rules adopted by the Commission, or (3) by any other action reasonably designed to implement the Commission's rules.

Review and Enforcement

Section 210(g) of PURPA provides one of the means of obtaining judicial review of a proceeding conducted by a State

regulatory authority or nonregulated utility for purposes of implementing the Commission's rules under section 210. Under subsection (g), review may be obtained pursuant to procedures set forth in section 123 of PURPA. Section 123(c)(1) contains provisions concerning judicial review and enforcement of determinations made by the State regulatory authorities and nonregulated utilities under Subtitle A, B, or C of Title I in the appropriate State court. These provisions also apply to review of any action taken to implement the rules under section 210. This means that persons can bring an action in State court to require the State regulatory authorities or nonregulated utilities to implement these regulations.

Section 123(c)(2) of PURPA provides that persons seeking review of any determination made by a Federal agency may bring an action in the appropriate Federal court. This distinction between Federal agencies and non-Federal agencies also applies to review of enforcement of the implementation of the rules under section 210.

Finally, the Commission believes that review and enforcement of implementation under section 210 of PURPA can consist not only of review and enforcement as to whether the State regulatory authority or nonregulated electric utility has conducted the initial implementation properly—namely, put into effect regulations implementing section 210 rules or procedures for that implementation, after notice and an opportunity for a hearing. It can also consist of review and enforcement of the application by a State regulatory authority or nonregulated electric utility, on a case-by-case basis, of its regulations or of any other provision it may have adopted to implement the Commission's rules under section 210.

Section 210(h)(2)(A) of PURPA states that the Commission may enforce the implementation of regulations under section 210(f). The Congress has provided not only for private causes of action in State courts to obtain judicial review and enforcement of the implementation of the Commission's rules under section 210, but also provided that the Commission may serve as a forum for review and enforcement of the implementation of this program.

§ 292.401 *Implementation by state regulatory authorities and nonregulated electric utilities*

Paragraph (a) of § 292.401 sets forth the obligation of each State regulatory authority to commence implementation of Subpart C within one year of the date these rules take effect. In complying with this paragraph the State regulatory authorities are required to provide for notice of and opportunity for public hearing. As described in the summary of this subpart, such implementation may consist of the adoption of the Commission's rules, an undertaking to resolve disputes between qualifying facilities and electric utilities arising under Subpart C, or any other action reasonably designed to implement Subpart C.

This section does not cover one provision of Subpart C which is not required to be implemented by the State regulatory authority or nonregulated electric utility. This provision is § 292.302 (Availability of electric utility system cost data), the implementation of which is subject to § 292.402, discussed below.

Subsection (b) sets forth the obligation of each nonregulated electric utility to commence, after notice and opportunity for public hearing, implementation of Subpart C. The nonregulated electric utilities, being both the regulator and the utility subject to the regulation, may satisfy the obligation to commence implementation of Subpart C through issuance of regulations, an undertaking to comply with Subpart C, or any other action reasonably designed to implement that subpart.

Paragraph (c) sets forth a reporting requirement under which each State regulatory authority and nonregulated electric utility is to file with the Commission, not later than one year after these rules take effect, a report describing the manner in which it is proceeding to implement Subpart C.

Comments received regarding this section indicated a concern that the obligation of a State regulatory authority or nonregulated utility "to commence implementation . . . within one year. . . ." did not provide any guidance as to when the process must be completed. The Commission notes that the intention of this section is that the State regulatory authorities

and nonregulated utilities have one year in which to establish procedures and that at the end of that year each State must be prepared to entertain applications. The phrase "commence implementation" is intended by the Commission to connote that implementation of these rules is a continuing process and that oversight will be ongoing.

§ 292.402 *Implementation of reporting objectives*

The obligation to comply with § 292.302 is imposed directly on electric utilities. This is different from the rest of Subpart C where the obligation to act is imposed on the State regulatory authority or the nonregulated electric utility in its role as regulator. The Commission is exercising its authority under section 133 of PURPA and other laws within the Commission's authority to require this reporting.

Any electric utility which fails to comply with the requirements of § 292.302(b) is subject to the same penalties as it might receive as a result of a failure to comply with the requirements of the Commission's regulations issued under section 133 of PURPA. As stated earlier in this preamble, the data required by § 292.302 will form the basis from which the rates for purchases will be derived; § 292.302 is thus a critical element in this program. The Commission believes that, with regard to utilities subject to section 133 of PURPA, the Commission may exercise its authority under section 133 to require the data required by § 292.302(b) on the basis that the Commission finds such information necessary to allow determination of the costs associated with providing electric services. With regard to utilities not subject to section 133, if they fail to provide the data called for in § 292.302(c), the Commission may compel its production under the Federal Power Act and other statutes which provide the Commission with authority to require reporting of such data.

§ 292.403 *Waivers.*

Paragraph (a) provides for a procedure by which any State regulatory authority or nonregulated electric utility may apply

for a waiver from the application of any of the requirements of Subpart C other than § 292.302. (Section 292.302(d) has been revised to permit a State regulatory authority or nonregulated utility to adopt a substitute method for the provision of system cost data without prior Commission approval.)

Paragraph (b) provides that the Commission will grant such a waiver only if the applicant can show that compliance with any of the requirements is not necessary to encourage cogeneration or small power production and is not otherwise required under section 210 of PURPA.

This section is included in recognition of the need for the Commission to afford flexibility to the States and nonregulated utilities to implement the Commission's rules under section 210.

Several comments suggested that the Commission set forth procedures for considering applications for waivers which would allow formal participation by qualifying facilities in a public hearing. The Commission notes that interested parties would be given an opportunity to be heard in any proceeding it conducts to determine whether or not a waiver should be granted.

SUBPART F—EXEMPTION OF QUALIFYING SMALL POWER PRODUCTION AND COGENERATION FACILITIES FROM CERTAIN FEDERAL AND STATE LAWS AND REGULATIONS

§ 292.601 *Exemption of qualifying facilities from the Federal Power Act.*

Section 210(e) of PURPA states that the Commission shall prescribe rules under which qualifying facilities are exempt, in part, from the Federal Power Act, from the Public Utility Holding Company Act of 1935, from State laws and regulations respecting the rates, or respecting the financial or organization regulation, of electric utilities, or from any combination of the foregoing, if the Commission determines such exemption is necessary to encourage cogeneration and small power production. As noted in the Staff Discussion Paper, the Con-

gress intended the Commission to make liberal use of its exemption authority in order to remove the disincentive of utility-type regulation. The Commission believes that broad exemption is appropriate.

Section 210(e)(2) of PURPA provides that the Commission is not authorized to exempt small power production facilities of 30 to 80 megawatt capacity from these laws. An exception is made for small power production facilities using biomass as a primary energy source. Such facilities between 30 and 80 megawatts may be exempted from the Public Utility Holding Company Act of 1935 and from State laws and regulations but may not be exempted from the Federal Power Act. The Commission will establish procedures for the determination of rates for these facilities in a separate proceeding.

Paragraph (a) sets forth those facilities which are eligible for exemption. Paragraph (b) provides that facilities described in paragraph (a) shall be exempted from all but certain specified sections of the Federal Power Act.

Section 210(e)(3)(C) of PURPA provides that no qualifying facility may be exempted from any license or permit requirement under Part I of the Federal Power Act. Accordingly, no qualifying facilities will be exempt from Part I of the Federal Power Act. The Commission recently issued simplified procedures for obtaining water power licenses for hydroelectric projects of 1.5 megawatts or less, and has issued proposed regulations to expedite licensing of existing facilities.[21]

The Commission believes cogeneration and small power production facilities could be the subject of an order under section 202(c) of the Federal Power Act requiring them to provide energy if the Economic Regulatory Administration determines that an emergency situation exists. Because application of this section is limited to emergency situations and is not affected by the fact that a facility attains qualifying status or

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21 *See* Order No. 11, Simplified Procedures for Certain Water Power Licenses, Docket No. RM79-9, issued September 5, 1978, and Application for License for Major Projects—Existing Dam, Docket No. RM79-36, 44 F.R. 24095 (April 21, 1979).

engages in interchanges with an electric utility, the Commission notes that qualifying facilities will not be exempted from section 202(c) of the Act.

Furthermore, in response to comment, the Commission has revised this paragraph to provide that qualifying facilities are not exempt from sections 210, 211, and 212 of the Federal Power Act, as required by section 210(e)(3)(B) of PURPA.

Sections 203, 204, 205, 206, 208, 301, 302, and 304 of the Federal Power Act reflect traditional rate regulation or regulation of securities of public utilities. The Commission has determined that qualifying facilities shall be exempted from these sections of the Federal Power Act.

Section 305(c) of the Act imposes certain reporting requirements on interlocking directorates. The Commission believes that any person who otherwise is required to file a report regarding interlocking positions should not be exempted from such requirement because he or she is also a director or officer of a qualifying facility.

Finally, the enforcement provisions of Part III of the Federal Power Act will continue to apply with respect to the sections of the Federal Power Act from which qualifying facilities are not exempt.

§ 292.602 *Exemption of qualifying facilities from the Public Utility Holding Company Act and certain State law and regulation.*

Under section 210(e) of PURPA the Commission can exempt qualifying facilities from regulation under the Public Utility Holding Company Act of 1935 and State laws and regulations concerning rates or financial organization. Only cogeneration facilities and small power production facilities of 30 megawatts or less may be exempted from both of these laws, with the exception that any qualifying small power production facility (*i.e.*, up to 80 megawatts) using biomass as a primary energy source can be exempted from these laws.

The Commission has determined that where a qualifying facility is subjected to more stringent regulation than other

companies solely by reason of the fact that it is engaged in the production of electric energy, these more stringent requirements should be eased through exemption of qualifying facilities. By excluding any qualifying facility from the definition of an "electric utility company" under section 2(a)(3) of the Public Utility Holding Company Act of 1935, such facilities would be removed from Public Utility Holding Company Act regulation which is applied exclusively to electric utility companies. Moreover, by excluding qualifying facilities from this definition, parent companies of qualifying facilities would not be subject to additional regulation as a result of electric production by their subsidiaries. The Commission therefore believes that in order to encourage cogeneration and small power production it is necessary to exempt cogenerators and small power producers from all of the provisions of the Public Utility Holding Company Act of 1935 related to electric utilities.

Accordingly, paragraph (b) states that no qualifying facility shall be considered to be an "electric utility company", as defined in section 2(a)(3) of the Public Utility Holding Company Act of 1935, 15 U.S.C. § 79b(a)(3).

Section 210(e) of PURPA states that qualifying facilities which may be exempted from the Public Utility Holding Company Act may also be exempted from State laws and regulations respecting the rates or financial organization of electric utilities.

The Commission has decided to provide a broad exemption from State laws and regulations which would conflict with the State's implementation of the Commission's rules under section 210.

The Commission believes that such broad exemption is necessary to encourage cogeneration or small power production. Accordingly, subparagraph (c)(1) provides that any qualifying facility shall be exempt from State laws and regulations respecting rates of electric utilities, and from financial and organizational regulation of electric utilities. Several commenters noted that this section might be interpreted as exempting qualifying facilities from state laws or regulations implement-

ing the Commission's rules, under section 210(f) of PURPA. In order to clarify that qualifying facilities are not to be exempt from these rules, the Commission has added subparagraph (c)(2) prohibiting any exemptions from State laws and regulations promulgated pursuant to Subpart C of these rules.

Some commenters indicated that § 292.301(b)(1) might be interpreted as prohibiting a State from reviewing contracts for purchases. These commenters stated that, as a part of a State's regulation of electric utilities, a State regulatory authority needs to be able to review contracts entered into by electric utilities it regulates.

These rules, and the exemptions being provided by these rules, are not intended to divest a State regulatory agency of its authority under State law to review contracts for purchases as part of its regulation of electric utilities. Such authority may continue to be exercised if consistent with the terms, policies and practices under sections 210 and 201 of PURPA and this Commission's implementing regulations. If the authority or its exercise is in conflict with these sections of PURPA or the Commission's regulations thereunder, the State must yield to the Federal requirements. The Commission does not believe it possible or advisable to attempt to establish more precise guidelines than these. Accordingly, States which have questions in this regard should seek an interpretive ruling from the Commission's General Counsel.

Subparagraph (c)(3) provides that, upon request of a State regulatory authority or nonregulated electric utility, the Commission may limit the applicability of the broad exemption from the State laws. This provision is intended to add flexibility to the exemption.

The Commission perceives that there may be instances in which a qualifying facility would wish to have an interpretation of whether or not it is subject to a particular State law in order to remove any uncertainty. Under subparagraph (c)(4), the Commission may determine whether a qualifying facility is exempt from a particular State law or regulation.

(Public Utility Regulatory Policies Act of 1978, 16 U.S.C. § 2601, *et seq.*, Energy Supply and Environmental Coor-

dination Act, 15 U.S.C. § 791 *et seq.*, Federal Power Act, as amended, 16 U.S.C. § 792 *et seq.*, Department of Energy Organization Act, 42 U.S.C. § 7101 *et seq.*, E.O. 12009, 42 *Fed. Reg.* 46267.)

IV. EFFECTIVE DATE

The regulations promulgated in this order are effective March 20, 1980.

In consideration of the foregoing, the Commission amends Part 292 of Chapter I, Title 18, Code of Federal Regulations, as set forth below, effective March 20, 1980. By the Commission.

(SEAL)

KENNETH F. PLUMB,
Secretary.

(1) Subchapter K is amended in the table of contents and in the text of the regulation by deleting the title for Part 292 and substituting the following in lieu thereof:

Part 292—Regulations Under Sections 201 and 210 of the Public Utility Regulatory Policies Act of 1978 With Regard to Small Power Production and Cogeneration.

(2) Subchapter K is further amended in the table of contents to Part 292 and in the text of the regulations by reserving Subpart B and by adding new Subparts A, C, D, and F to read as follows:

Part 292—Regulations Under Sections 201 and 210 of the Public Utility Regulatory Policies Act of 1978 With Regard to Small Power Production and Cogeneration.

SUBPART A—GENERAL PROVISIONS

Sec.
292.101 Definitions.

SUBPART B—[RESERVED]

SUBPART C—ARRANGEMENTS BETWEEN ELECTRIC UTILITIES AND QUALIFYING COGENERATION AND SMALL POWER PRODUCTION FACILITIES UNDER SECTION 210 OF THE PUBLIC UTILITY REGULATORY POLICIES ACT OF 1978

Sec.
292.301 Scope.
292.302 Availability of Electric Utility System Cost Data.
292.303 Electric Utility Obligations Under This Subpart.
292.304 Rates for Purchases.
292.305 Rates for Sales.
292.306 Interconnection Costs.
292.307 System Emergencies.
292.308 Standards for Operating Reliability.

SUBPART D—IMPLEMENTATION

Sec.
292.401 Implementation by State Regulatory Authorities and Nonregulated Utilities.
292.402 Implementation of Certain Reporting Requirements.
292.403 Waivers.

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SUBPART F—EXEMPTION OF QUALIFYING SMALL POWER PRODUCTION FACILITIES AND COGENERATION FACILITIES FROM CERTAIN FEDERAL AND STATE LAWS AND REGULATIONS

Sec.
292.601 Exemption of Qualifying Facilities from the Federal Power Act.
292.602 Exemption of Qualifying Facilites From the Public Utility Holding Company Act and Certain State Law and Regulation.

(Authority: This part issued under the Public Utility Regulatory Policies Act of 1978, 16 U.S.C. § 2601 *et seq.*, Energy Supply and Environment Coordination Act, 15 U.S.C. § 791 *et seq.*, Federal Power Act, 16 U.S.C. § 792 *et seq.*, Department of Energy Organization Act, 42 U.S.C. § 7101 *et seq.*, E.O. 12009, 42 F.R. 46267.)

SUBPART A—GENERAL PROVISIONS

§ 292.101 *Definitions.*

(a) *General rule.* Terms defined in the Public Utility Regulatory Policies Act of 1978 (PURPA) shall have the same meaning for purposes of this part as they have under PURPA, unless further defined in this part.

(b) *Definitions.* The following definitions apply for purposes of this part.

(1) "Qualifying facility" means a cogeneration facility or a small power production facility which is a qualifying facility under Subpart B of this part of the Commission's regulations.

(2) "Purchase" means the purchase of electric energy or capacity or both from a qualifying facility by an electric utility.

(3) "Sale" means the sale of electric energy or capacity or both by an electric utility to a qualifying facility.

(4) "System emergency" means a condition on a utility's system which is likely to result in imminent significant disruption of service to customers or is imminently likely to endanger life or property.

(5) "Rate" means any price, rate, charge, or classification made, demanded, observed or received with respect to the sale or purchase of electric energy or capacity, or any rule, regulation, or practice respecting any such rate, charge, or classification, and any contract pertaining to the sale or purchase of electric energy or capacity.

(6) "Avoided costs" means the incremental costs to an electric utility of electric energy or capacity or both which, but for the purchase from the qualifying facility or qualifying facilities, such utility would generate itself or purchase from another source.

(7) "Interconnection costs" means the reasonable costs of connection, switching, metering, transmission, distribution, safety provisions and administrative costs incurred by the electric utility directly related to the installation and maintenance of the physical facilities necessary to permit interconnected operations with a qualifying facility, to the extent such costs are in excess of the corresponding costs which the electric utility would have incurred if it had not engaged in interconnected operations, but instead generated an equivalent amount of electric energy itself or purchased an equivalent amount of electric energy or capacity from other sources. Interconnection costs do not include any costs included in the calculation of avoided costs.

(8) "Supplementary power" means electric energy or capacity supplied by an electric utility, regularly used by a qualifying facility in addition to that which the facility generates itself.

(9) "Back-up power" means electric energy or capacity supplied by an electric utility to replace energy ordinarily generated by a facility's own generation equipment during an unscheduled outage of the facility.

(10) "Interruptible power" means electric energy or capacity supplied by an electric utility subject to interruption by the electric utility under specified conditions.

(11) "Maintenance power" means electric energy or capacity supplied by an electric utility during scheduled outages of the qualifying facility.

SUBPART B—[RESERVED]

SUBPART C—ARRANGEMENTS BETWEEN ELECTRIC UTILITIES AND QUALIFYING COGENERATION AND SMALL POWER PRODUCTION FACILITIES UNDER SECTION 210 OF THE PUBLIC UTILITY REGULATORY POLICIES ACT OF 1978

§ 292.301 *Scope.*

(a) *Applicability.* This subpart applies to the regulation of sales and purchases between qualifying facilities and electric utilities.

(b) *Negotiated rates or terms.* Nothing in this subpart:

(1) limits the authority of any electric utility or any qualifying facility to agree to a rate for any purchase, or terms or conditions relating to any purchase, which differ from the rate or terms or conditions which would otherwise be required by this subpart; or

(2) affects the validity of any contract entered into between a qualifying facility and an electric utility for any purchase.

§ 292.302 *Availability of electric utility system cost data.*

(a) *Applicability.* (1) Except as provided in subparagraph (2), paragraph (b) applies to each electric utility, in any calendar year, if the total sales of electric energy by such utility for purposes other than resale exceeded 500 million kilowatt-hours during any calendar year beginning after December 31, 1975, and before the immediately preceding calendar year.

(2) Each utility having total sales of electric energy for purposes other than resale of less than one billion kilowatt-hours during any calendar year beginning after December 31, 1975, and before the immediately preceding year, shall not be subject to the provisions of this section until May 31, 1982.

(b) *General rule.* To make available data from which avoided costs may be derived, not later than November 1, 1980, May 31, 1982, and not less often than every two years thereafter, each regulated electric utility described in paragraph (a) shall provide to its State regulatory authority, and shall maintain for public inspection, and each nonregulated electric utility described in paragraph (a) shall maintain for public inspection, the following data:

(1) the estimated avoided cost on the electric utility's system, solely with respect to the energy component, for various levels of purchases from qualifying facilities. Such levels of purchases shall be stated in blocks of not more than 100 megawatts for systems with peak demand of 1000 megawatts or more, and in blocks equivalent to not more than 10 percent of the system peak demand for systems of less than 1000 megawatts. The avoided costs shall be stated on a cents per

kilowatt-hour basis, during daily and seasonal peak and off-peak periods, by year, for the current calendar year and each of the next 5 years;

(2) the electric utility's plan for the addition of capacity by amount and type, for purchases of firm energy and capacity, and for capacity retirements for each year during the succeeding 10 years; and

(3) the estimated capacity costs at completion of the planned capacity additions and planned capacity firm purchases, on the basis of dollars per kilowatt, and the associated energy costs of each unit, expressed in cents per kilowatt hour. These costs shall be expressed in terms of individual generating units and of individual planned firm purchases.

(c) *Special rule for small electric utilities.*

(1) Each electric utility (other than any electric utility to which paragraph (b) applies) shall, upon request:

(i) provide comparable data to that required under paragraph (b) to enable qualifying facilities to estimate the electric utility's avoided costs for periods described in paragraph (b); or

(ii) with regard to an electric utility which is legally obligated to obtain all its requirements for electric energy and capacity from another electric utility, provide the data of its supplying utility and the rates at which it currently purchases such energy and capacity.

(2) If any such electric utility fails to provide such information on request, the qualifying facility may apply to the State regulatory authority (which has ratemaking authority over the electric utility) or the Commission for an order requiring that the information be provided.

(d) *Substitution of alternative method.* (1) After public notice in the area served by the electric utility, and after opportunity for public comment, any State regulatory authority may require (with respect to any electric utility over which it has ratemaking authority), or any nonregulated electric utility may provide, data different than those which are otherwise required by this section if it determines that avoided costs can be derived from such data.

(2) Any State regulatory authority (with respect to any electric utility over which it has ratemaking authority) or nonregulated utility which requires such different data shall notify the Commission within 30 days of making such determination.

(e) *State review.* (1) Any data submitted by an electric utility under this section shall be subject to review by the State regulatory authority which has ratemaking authority over such electric utility.

(2) In any such review, the electric utility has the burden of coming forward with justification for its data.

§ 292.303 *Electric utility obligations under this subpart.*

(a) *Obligation to purchase from qualifying facilities.* Each electric utility shall purchase, in accordance with § 292.304, any energy and capacity which is made available from a qualifying facility:

(1) directly to the electric utility; or

(2) indirectly to the electric utility in accordance with paragraph (d).

(b) *Obligation to sell to qualifying facilities.* Each electric utility shall sell to any qualifying facility, in accordance with § 292.305, any energy and capacity requested by the qualifying facility.

(c) *Obligation to interconnect.* (1) Subject to subparagraph (2), any electric utility shall make such interconnections with any qualifying facility as may be necessary to accomplish purchases or sales under this subpart. The obligation to pay for any interconnection costs shall be determined in accordance with § 292.306.

(2) No electric utility is required to interconnect with any qualifying facility if, solely by reason of purchases or sales over the interconnection, the electric utility would become subject to regulation as a public utility under Part II of the Federal Power Act.

(d) *Transmission to other electric utilities.* If a qualifying facility agrees, an electric utility which would otherwise be obligated to purchase energy or capacity from such qualifying facility may transmit the energy or capacity to any other electric utility. Any electric utility to which such energy or capacity is transmitted shall purchase such energy or capacity under this subpart as if the qualifying facility were supplying energy or capacity directly to such electric utility. The rate for purchase by the electric utility to which such energy is transmitted shall be adjusted up or down to reflect line losses pursuant to § 292.304(e)(4) and shall not include any charges for transmission.

(e) *Parallel operation.* Each electric utility shall offer to operate in parallel with a qualifying facility, provided that the qualifying facility complies with any applicable standards established in accordance with § 292.308.

§ 292.304 *Rates for purchases.*

(a) *Rates for purchases.* (1) Rates for purchases shall:

(i) be just and reasonable to the electric consumer of the electric utility and in the public interest; and

(ii) not discriminate against qualifying cogeneration and small power production facilities.

(2) Nothing in this subpart requires any electric utility to pay more than the avoided costs for purchases.

(b) *Relationship to avoided costs.* (1) For purposes of this paragraph, "new capacity" means any purchase from capacity of a qualifying facility, construction of which was commenced on or after November 9, 1978.

(2) Subject to subparagraph (3), a rate for purchases satisfies the requirements of paragraph (a) if the rate equals the avoided costs determined after consideration of the factors set forth in paragraph (e).

(3) A rate for purchases (other than from new capacity) may be less than the avoided cost if the State regulatory authority (with respect to any electric utility over which it has ratemaking authority) or the nonregulated electric utility determines that a

lower rate is consistent with paragraph (a), and is sufficient to encourage cogeneration and small power production.

(4) Rates for purchases from new capacity shall be in accordance with subparagraph (2), regardless of whether the electric utility making such purchases is simultaneously making sales to the qualifying facility.

(5) In the case in which the rates for purchases are based upon estimates of avoided costs over the specific term of the contract or other legally enforceable obligation, the rates for such purchases do not violate this subpart if the rates for such purchases differ from avoided costs at the time of delivery.

(c) *Standard rates for purchases.* (1) There shall be put into effect (with respect to each electric utility) standard rates for purchases from qualifying facilities with a design capacity of 100 kilowatts or less.

(2) There may be put into effect standard rates for purchases from qualifying facilities with a design capacity of more than 100 kilowatts.

(3) The standard rates for purchases under this paragraph:

(i) shall be consistent with paragraphs (a) and (e); and

(ii) may differentiate among qualifying facilities using various technologies on the basis of the supply characteristics of the different technologies.

(d) *Purchases "as available" or pursuant to a legally enforceable obligation.* Each qualifying facility shall have the option either:

(1) to provide energy as the qualifying facility determines such energy to be available for such purchases, in which case the rates for such purchases shall be based on the purchasing utility's avoided costs calculated at the time of delivery; or

(2) to provide energy or capacity pursuant to a legally enforceable obligation for the delivery of energy or capacity over a specified term, in which case the rates for such purchases shall, at the option of the qualifying facility exercised prior to the beginning of the specified term, be based on either:

(i) the avoided costs calculated at the time of delivery; or

(ii) the avoided costs calculated at the time the obligation is incurred.

(e) *Factors affecting rates for purchases.* In determining avoided costs, the following factors shall, to the extent practicable, be taken into account:

(1) the data provided pursuant to § 292.302(b), (c), or (d), including State review of any such data;

(2) the availability of capacity or energy from a qualifying facility during the system daily and seasonal peak periods, including:

(i) the ability of the utility to dispatch the qualifying facility;

(ii) the expected or demonstrated reliability of the qualifying facility;

(iii) the terms of any contract or other legally enforceable obligation, including the duration of the obligation, termination notice requirement and sanctions for non-compliance;

(iv) the extent to which scheduled outages of the qualifying facility can be usefully coordinated with scheduled outages of the utility's facilities;

(v) the usefulness of energy and capacity supplied from a qualifying facility during system emergencies, including its ability to separate its load from its generation;

(vi) the individual and aggregate value of energy and capacity from qualifying facilities on the electric utility's system; and

(vii) the smaller capacity increments and the shorter lead times available with additions of capacity from qualifying facilities; and

(3) the relationship of the availability of energy or capacity from the qualifying facility as derived in subparagraph (2), to the ability of the electric utility to avoid costs, including the deferral of capacity additions and the reduction of fossil fuel use; and

(4) the costs or savings resulting from variations in line losses from those that would have existed in the absence of purchases from a qualifying facility, if the purchasing electric utility generated an equivalent amount of energy itself or purchased an equivalent amount of electric energy or capacity.

(f) *Periods during which purchases not required.*

(1) Any electric utility which gives notice pursuant to subparagraph (2) will not be required to purchase electric energy or capacity during any period during which, due to operational circumstances, purchases from qualifying facilities will result in costs greater than those which the utility would incur if it did not make such purchases, but instead generated an equivalent amount of energy itself.

(2) Any electric utility seeking to invoke subparagraph (1) must notify, in accordance with applicable State law or regulation, each affected qualifying facility in time for the qualifying facility to cease the delivery of energy or capacity to the electric utility.

(3) Any electric utility which fails to comply with the provisions of subparagraph (2) will be required to pay the same rate for such purchase of energy or capacity as would be required had the period described in subparagraph (1) not occurred.

(4) A claim by an electric utility that such a period has occurred or will occur is subject to such verification by its State regulatory authority as the State regulatory authority determines necessary or appropriate, either before or after the occurrence.

§ 292.305 *Rates for sales.*

(a) *General rules.* (1) Rates for sales:

(i) shall be just and reasonable and in the public interest; and

(ii) shall not discriminate against any qualifying facility in comparison to rates for sales to other customers served by the electric utility.

(2) Rates for sales which are based on accurate data and consistent systemwide costing principles shall not be considered to discriminate against any qualifying facility to the extent that such rates apply to the utility's other customers with similar load or other cost-related characteristics.

(b) *Additional Services to be Provided to Qualifying Facilities.* (1) Upon request of a qualifying facility, each electric utility shall provide:

(i) supplementary power;
(ii) back-up power;
(iii) maintenance power; and
(iv) interruptible power.

(2) The State regulatory authority (with respect to any electric utility over which it has ratemaking authority) and the Commission (with respect to any nonregulated electric utility) may waive any requirement of subparagraph (1) if, after notice in the area served by the electric utility and after opportunity for public comment, the electric utility demonstrates and the State regulatory authority or the Commission, as the case may be, finds that compliance with such requirement will:

(i) impair the electric utility's ability to render adequate service to its customers; or

(ii) place an undue burden on the electric utility.

(c) *Rates for sales of back-up and maintenance power.* The rate for sales of back-up power or maintenance power:

(1) shall not be based upon an assumption (unless supported by factual data) that forced outages or other reductions in electric output by all qualifying facilities on an electric utility's system will occur simultaneously, or during the system peak, or both; and

(2) shall take into account the extent to which scheduled outages of the qualifying facilities can be usefully coordinated with scheduled outages of the utility's facilities.

§ 292.306 *Interconnection costs.*

(a) *Obligation to pay.* Each qualifying facility shall be obligated to pay any interconnection costs which the State regulatory authority (with respect to any electric utility over which it has ratemaking authority) or nonregulated electric utility may assess against the qualifying facility on a nondiscriminatory basis with respect to other customers with similar load characteristics.

(b) *Reimbursement of interconnection costs.* Each State regulatory authority (with respect to any electric utility over

which it has ratemaking authority) and nonregulated utility shall determine the manner for payments of interconnection costs, which may include reimbursement over a reasonable period of time.

§ 292.307 *System emergencies.*

(a) *Qualifying facility obligation to provide power during system emergencies.* A qualifying facility shall be required to provide energy or capacity to an electric utility during a system emergency only to the extent:

(1) provided by agreement between such qualifying facility and electric utility; or

(2) ordered under section 202(c) of the Federal Power Act.

(b) *Discontinuance of purchases and sales during system emergencies.* During any system emergency, an electric utility may discontinue:

(1) purchases from a qualifying facility if such purchases would contribute to such emergency; and

(2) sales to a qualifying facility, provided that such discontinuance is on a nondiscriminatory basis.

§ 292.308 *Standards for operating reliability.*

Any State regulatory authority (with respect to any electric utility over which it has ratemaking authority) or nonregulated electric utility may establish reasonable standards to ensure system safety and reliability of interconnected operations. Such standards may be recommended by any electric utility, any qualifying facility, or any other person. If any State regulatory authority (with respect to any electric utility over which it has ratemaking authority) or nonregulated electric utility establishes such standards, it shall specify the need for such standards on the basis of system safety and reliability.

SUBPART D—IMPLEMENTATION

§ 292.401 *Implementation by State regulatory authorities and nonregulated electric utilities.*

(a) *State regulatory authorities.* Not later than one year after these rules take effect, each State regulatory authority shall, after notice and an opportunity for public hearing, commence implementation of Subpart C (other than § 292.302 thereof). Such implementation may consist of the issuance of regulations, an undertaking to resolve disputes between qualifying facilities and electric utilities arising under Subpart C, or any other action reasonably designed to implement such subpart (other than § 292.302 thereof).

(b) *Nonregulated electric utilities.* Not later than one year after these rules take effect, each nonregulated electric utility shall, after notice and an opportunity for public hearing, commence implementation of Subpart C (other than § 292.302 thereof). Such implementation may consist of the issuance of regulations, an undertaking to comply with Subpart C, or any other action reasonably designed to implement such subpart (other than § 292.302 thereof).

(c) *Reporting requirement.* Not later than one year after these rules take effect, each State regulatory authority and nonregulated electric utility shall file with the Commission a report describing the manner in which it will implement Subpart C (other than § 292.302 therof).

§ 292.402 *Implementation of Certain Reporting Requirements.*

Any electric utility which fails to comply with the requirements of § 292.302(b) shall be subject to the same penalties to which it may be subjected for failure to comply with the requirements of the Commission's regulations issued under section 133 of PURPA.

§ 292.403 *Waivers.*

(a) *State regulatory authority and nonregulated electric utility waivers.* Any State regulatory authority (with respect to any electric utility over which it has ratemaking authority) or nonregulated electric utility may, after public notice in the area served by the electric utility, apply for a waiver from the application of any of the requirements of Subpart C (other than § 292.302 thereof).

(b) *Commission action.* The Commission will grant such a waiver only if an applicant under paragraph (a) demonstrates that compliance with any of the requirements of Subpart C is not necessary to encourage cogeneration and small power production and is not otherwise required under section 210 of PURPA.

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SUBPART F—EXEMPTION OF QUALIFYING SMALL POWER PRODUCTION FACILITIES AND COGENERATION FACILITIES FROM CERTAIN FEDERAL AND STATE LAWS AND REGULATIONS

§ 292.601 *Exemption to qualifying facilities from the Federal Power Act.*

(a) *Applicability.* This section applies to:

(1) qualifying cogeneration facilities; and

(2) qualifying small power production facilities which have a power production capacity which does not exceed 30 megawatts.

(b) *General rule.* Any qualifying facility described in paragraph (a) shall be exempt from all sections of the Federal Power Act, except:

(1) sections 1-30;

(2) sections 202(c), 210, 211, and 212;

(3) section 305(c); and

(4) any necessary enforcement provision of Part III with regard to the sections listed in subparagraphs (1), (2) and (3).

§ 292.602 *Exemption to qualifing facilities from the Public Utility Holding Company Act and certain State law and regulation.*

(a) *Applicability.* This section applies to any qualifying facility described in § 292.601(a), and to any qualifying small power production facility with a power production capacity over 30 megawatts if such facility produces electric energy solely by the use of biomass as a primary energy source.

(b) *Exemption from the Public Utility Holding Company Act of 1935.* A qualifying facility described in paragraph (a) shall not be considered to be an "electric utility company" as defined in section 2(a)(3) of the Public Utility Holding Company Act of 1935, 15 U.S.C. § 79b(a)(3).

(c) *Exemption from certain State law and regulation.*

(1) Any qualifying facility shall be exempted (except as provided in subparagraph (2)) from State law or regulation respecting:

(i) the rates of electric utilities; and

(ii) the financial and organizational regulation of electric utilities.

(2) A qualifying facility may not be exempted from State law and regulation implementing Subpart C.

(3) Upon request of a State regulatory authority or nonregulated electric utility, the Commission may consider a limitation on the exemptions specified in subparagraph (1).

(4) Upon request of any person, the Commission may determine whether a qualifying facility is exempt from a particular State law or regulation.

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

(18 CFR Part 292)

Docket No. RM79-54

Before Commissioners:

Charles B. Curtis, *Chairman;*
Georgiana Sheldon, Matthew Holden, Jr.,
and George R. Hall.

SMALL POWER PRODUCTION AND
COGENERATION FACILITIES — QUALIFYING STATUS

ORDER NO. 70

FINAL RULE ESTABLISHING REQUIREMENTS AND
PROCEDURES FOR A DETERMINATION OF QUALIFYING
STATUS FOR SMALL POWER PRODUCTION
AND COGENERATION FACILITIES

(Issued March 13, 1980)

Section 201 of the Public Utility Regulatory Policies Act of 1978 (PURPA) mandates that the Federal Energy Regulatory Commission (Commission) prescribe rules under which small power production facilities and cogeneration facilities can obtain "qualifying" status, and thus become eligible for the rates and exemptions set forth in the Commission's rules implementing section 210 of PURPA.

Section 201 of PURPA[1] defines a "small power production facility" as a facility which:

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1 Section 3(17)(A) of the Federal Power Act.

(1) produces electric energy solely by the use, as a primary energy source, of biomass, waste, renewable resources, or any combination thereof; and
(2) has a power production capacity which, together with any other facilities located at the same site (as determined by the Commission), is not greater than 80 megawatts.

A cogeneration facility is defined as a facility which produces electric energy and steam or forms of useful energy (such as heat) which are used for industrial, commercial, heating, or cooling purposes.[2]

Thus, cogeneration facilities simultaneously produce two forms of useful energy, namely electric power and heat. Cogeneration facilities can use significantly less fuel to produce electricity and steam (or other forms of energy) than would be needed to produce the two separately. By using fuels more efficiently, cogeneration facilities can make a significant contribution to the Nation's effort to conserve its energy resources.

Small power production facilities as defined in the Act use biomass, waste, or renewable resources, including wind, solar energy and water, to produce electric power. Reliance on these sources of energy can reduce the need to consume fossil fuels to generate electric power.

Prior to the enactment of PURPA, a cogenerator or small power producer seeking to establish interconnected operation with a utility faced three major obstacles. First, a utility was not generally willing to purchase the electric output or was not willing to pay an appropriate rate. Secondly, some utilities charged discriminatorily high rates for back-up service to cogenerators and small power producers. Thirdly, a cogenerator or small power producer which provided electricity to a utility's grid ran the risk of being considered an electric utility and thus being subjected to extensive State and Federal regulation.

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2 Section 3(18)(A) of the Federal Power Act.

Sections 201 and 210 of PURPA are designed to remove these obstacles. Each electric utility is required under section 210 to offer to purchase available electric energy from cogeneration and small power production facilities which obtain qualifying status under section 201 of PURPA, and to provide back-up power and other services to such facilities on a non-discriminatory basis. For such purchases, electric utilities are required to pay rates which are just and reasonable to the ratepayers of the utility, which are in the public interest, and which do not discriminate against cogenerators and small power producers. Section 210(e) of PURPA provides that the Commission can exempt qualifying facilities from State regulation regarding utility rates and financial organization, from Federal regulation under the Federal Power Act (other than licensing under Part I), and from the Public Utility Holding Company Act. Finally, under section 206(c)(3) of the Natural Gas Policy Act of 1978 (NGPA), the Commission may exempt qualifying cogeneration facilities from the incremental pricing program under Title II of the NGPA.

In this rulemaking, the Commission sets forth requirements for qualifying cogeneration and small power production facilities and procedures by which such facilities may obtain qualification. Rules implementing section 210 of PURPA have been prescribed in Docket No. RM79-55.[3]

Any qualifying facility is eligible for the exemptions set forth in Subpart F of this part of the Commission's regulations immediately upon issuance of these rules. With regard to the rate benefits for qualifying facilities found in Subpart C of this part, however, the statute provides that the State regulatory authorities and nonregulated electric utilities will have up to one year to implement the Commission's rules. Therefore, the latest date by which qualifying facilities will be eligible to receive these PURPA-derived rate benefits is February 19, 1981.

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[3] 18 C.F.R. Part 292, Subparts A, C, D and F; 45 Fed. Reg. 12214 (Feb. 25, 1980).

I. PROCEDURAL HISTORY

On June 27, 1979, the Commission issued proposed rules in this docket[4] to determine which cogeneration and small power production facilities may become "qualifying" cogeneration or small power production facilities under section 201 of PURPA.

Public hearings on RM79-54 were held in San Francisco on July 23, 1979, Chicago on July 27, 1979, and Washington, D.C. on July 30, 1979. Written comments were also received.

On October 18, 1979, the Commission issued a Notice of Proposed Rulemaking Under Section 210 of PURPA in Docket No. RM79-55.[5] On October 19, 1979, the Commission made available its preliminary Environmental Assessment (EA) of the proposed rules in Docket Nos. RM79-54 and RM79-55.

In a Request for Further Comments[6], the Commission requested further public comment on both proposed rules, and on the findings set forth in the preliminary EA. In order to obtain the data, views, and arguments of interested persons, the Commission Staff held public hearings in Seattle on November 19, 1979, in New York City on November 28, 1979, in Denver on November 30, 1979, and in Washington, D.C. on December 4 and 5, 1979. The Commission also received written comment. All of the comments were considered in the formulation of this final rule.

II. SUMMARY

These rules set forth criteria and procedures by which cogeneration and small power production facilities can obtain qualifying status to receive the rate benefits and exemptions set forth in the Commission's rules implementing section 210 of PURPA.

The rules in this docket permit qualification without a need for specific Commission action. They also make available an

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4 44 Fed. Reg. 38872 (July 3, 1979).

5 44 Fed. Reg. 61190 (Oct. 24, 1979).

6 44 Fed. Reg. 61977 (Oct. 29, 1979).

optional procedure under which, should it prove desirable, a facility can gain certification as a "qualifying facility." For qualifying small power production facilities, the efficiency standards contained in the proposed rule have been eliminated, and the permitted level of oil, natural gas and coal use for startup, testing, flame stabilization, and operation during outages of the primary energy supply system has been increased and the form of that requirement has been simplified. For qualifying cogeneration facilities, efficiency standards still must be met by certain new facilities using oil or gas. In addition, certain operating standards have been adopted for purposes of assuring that a qualifying cogenerator is a *bona fide* generator.

III. SECTION-BY-SECTION ANALYSIS

§ 292.201 *Scope.*

Section 292.201 describes the scope of Subpart B of the Commission's rules. Subpart B provides the criteria for and manner of qualification of small power production and cogeneration facilities.

§ 292.202 *Definitions.*

This section contains definitions applicable to this subpart of the Commission's rules.

Paragraph (a) defines "biomass" as any organic material not derived from fossil fuels. The proposed rule defined "biomass" as plant materials which are obtained from cultivation, or harvested from naturally occurring vegetation without significant depletion of the resource. Commenters recommended that the Commission expand the definition to include any organic material not derived from fossil fuels. The commenters stated that most studies dealing with energy recovery from organic material other than fossil fuels have included municipal (and most industrial) solid waste within the more general category of biomass.

The Commission agrees with the commenters who urged the Commission to expand the scope of this definition. The Com-

mission observes that applying a narrow definition of biomass might hinder development of small power production facilities between 30 megawatts and 80 megawatts in capacity. Use of a definition of biomass which includes by-products of the manufacturing, harvesting, and growing of agricultural products, including wood, will enable a greater number of small power producers between 30 and 80 megawatts to take advantage of the exemption from State law and regulation regarding rates and financial organization of electric utilities and from the Public Utility Holding Company Act, as provided in Subpart F of this part of the Commission's rules.

One commenter questioned whether the Commission meant to include peat within the definition of biomass. The Commission wishes to clarify this point by stating that peat is included in the definition of biomass for purposes of this subpart.

Paragraph (b) defines "waste" as any by-product materials other than biomass. In most instances, waste is a by-product of fossil fuels. Examples of waste include petroleum coke, refinery gas, and plastics.

Paragraph (c) defines "cogeneration facility" as equipment used to produce electric energy and forms of useful thermal energy (such as heat or steam), used for industrial, commercial, heating, or cooling purposes, through the sequential use of energy.

Several commenters requested clarification of the applicability of the Commission's rules to cogeneration in the residential sector. The issue arises because of the absence of any explicit mention of residential energy use in the statutory language. The Commission's definition of cogeneration facility tracks the statutory language in that residential use is not specifically identified.

The Commission intends that residential sector cogeneration be included. The Commission believes that the phrase "heating, or cooling purposes" applies to any industrial, commercial, or residential heating or cooling purpose. The Commission has not found anything in the legislative history of PURPA which suggests that the terms "industrial" and "commercial" were intended to modify "heating, or cooling". Sepa-

rate mention of "residential" use is unnecessary because heating and cooling adequately encompass the residential use of thermal energy. In the industrial sector, thermal energy in the form of process steam is used as an input to many industrial processes. The separate identification of industrial and heating uses is necessary since not all industrial uses of thermal energy are for heating or cooling purposes. In addition, in many instances, commercial heating purposes include heating of residential apartment buildings, so that the exclusion of residential heating and cooling from this program would be difficult to accomplish even if such purpose were within the realm of statutory construction.

Sequential Use

Several commenters recommended that the Commission define cogeneration as the "combined" or "joint" production of heat and power. However, the terms "combined" or "joint" production of heat and power do not fully describe the cogeneration process. The final rules contain an explicit requirement for the sequential use of energy in cogeneration facilities. This means that rejected heat from a power production or heating process is used in another power production or heating process. It is precisely this "cascading" use of energy in sequential processes that gives rise to the energy conserving characteristic of cogeneration.

By adding the phrase "through the sequential use of energy" to the definition of cogeneration facility, the Commission makes explicit what was intended in the proposed rule. The discussions in the proposed rule relating to topping and bottoming-cycle cogeneration and the efficiency standards were expressed in the context of sequential use. Many commenters apparently recognized this fact and, in their discussions of alternative efficiency standards, compared hypothetical cogeneration systems to reference cases of noncogeneration, separate production of heat and power. Additionally, the explanation of supplementary firing in the proposed rules implied that energy inputs other than supplementary firing would

have to flow through both a thermal and a power production process. The explicit mention of sequential use is therefore not a new requirement; it is a clarification of intent.

Several comments filed in this rulemaking in response to the Commission's November 9, 1979 Interim Rule[7] raised questions about how the sequential use concept would apply in certain situations. One commenter noted that many industries commonly route steam directly from their boilers to processes without expansion in a turbine. This practice is simply the raising of process steam; it is not cogeneration. The fact that some other steam from the same boiler is routed to cogeneration equipment does not mean that all steam from the boiler is used for cogeneration. The coincident raising of process steam relates to the cogeneration rules in two ways. First, any energy expended in raising such steam should not be entered into any efficiency calculations. Secondly, natural gas used for raising process steam is not rendered exempt from incremental pricing solely because the boiler may also supply steam for cogeneration.

A commenter also questioned the applicability of the sequential use test to a combustion turbine coupled with a waste heat recovery boiler. The commenter noted that the boiler could not capture all of the heat in the turbine exhaust and thus not all of the turbine's power could be said to be sequential. The Commission does not adopt this interpretation. The high efficiency of combustion turbine/waste heat recovery boilers derives from the fact that a substantial quantity of waste heat is recovered. The Commission does not require that all heat be recovered. Strictly speaking, some of the available thermal energy in a steam turbine cogeneration system is lost (due to pressure drop in piping along with convective and radiative heat losses) before the steam is delivered to a useful process. As long as any applicable efficiency and operating standards are met, the Commission is not concerned with energy losses within the system.

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[7] Interim Rule for Qualification of Gas-Fired Cogeneration Facilities for Purposes of the Incremental Pricing Program, 44 Fed. Reg. 65744 (Nov. 15, 1979).

A final issue concerning the definition of a cogeneration facility involves combined-cycle electric generation plants. Such plants burn gaseous or liquid fuels in a combustion turbine and use the turbine exhaust to raise steam. The steam is directed through a fully condensing steam turbine. Only electricity is produced, albeit through the sequential use of energy. The Commission is of the opinion that combined-cycle electric generation plants are not cogeneration facilities, since only one form of energy is produced.

In paragraph (d), the Commission has added the definition of "topping-cycle cogeneration facility" which is a cogeneration facility in which the energy input to the facility is first used to produce power, and the reject heat from power production is then used to provide useful heat.

Paragraph (e) has been added to define a "bottoming-cycle cogeneration facility" as a cogeneration facility in which the energy input to the system is first applied to a useful heating process, and the residual heat emerging from the process is then used for power production.

The Commission has added paragraph (f), which defines "supplementary firing" as an energy input to the cogeneration facility used only in the thermal process of a topping-cycle cogeneration facility, or only in the electric generating process of a bottoming-cycle cogeneration facility.

The distinguishing characteristic of supplementary firing as defined here is that none of the energy is used sequentially. In topping cycles, supplementary firing is commonly practiced by introducing natural gas or oil into the hot exhaust of a combustion turbine. The turbine exhaust will typically have sufficient oxygen to support combustion of the added fuel. The resulting heat can either be used directly in a high-temperature direct heat application or used to raise process steam. Supplementary firing is also possible in steam turbine cogeneration facilities, through reheat of steam which exits from a turbine. In all cases, the added energy is not used to produce power as well as useful thermal energy.

In a bottoming-cycle cogeneration facility, supplementary firing can be used to increase the output of the power produc-

tion equipment by firing additional fuel in the thermal process exhaust. Again, the added energy is not used sequentially for both power production and a thermal process.

The Commission recognizes that there will be questions as to the application of the standards of this subpart to complex facilities which may contain combinations of topping and bottoming-cycle cogeneration equipment. The optional procedure for qualification under § 292.207 is available specifically to help any cogenerator who wishes clarification as to whether his facility would qualify.

Paragraph (g) adds the definition of "useful power output" of a cogeneration facility as the electrical or mechanical energy made available for use, exclusive of any such energy used in the power production process. Although electric power output is required of a qualifying facility, any additional mechanical power may be taken into account in determining "useful power output".

Paragraph (h) has been added to define "useful thermal energy output" of a topping-cycle cogeneration facility as the thermal energy made available for use in any industrial or commercial process, or used in any heating or cooling application.

The proposed rules contained a definition of the "useful energy output of a thermal process." The term was intended to reflect the heat actually used in a thermal process rather than heat made available for use. The proposed term found application in proposed efficiency standards for both topping and bottoming cycles. Only a few commenters mentioned the proposed term, but they did raise serious questions about the feasibility (and desirability) of performing the necessary calculations. It was argued that computation of the "useful energy output of a thermal process" in accordance with the proposed definition would be difficult and would yield unintended results—particularly in the case of bottoming cycles.

The Commission notes that in its final rules the efficiency of bottoming-cycle facilities is evaluated only with respect to supplementary firing. No evaluation of efficiency is now required for the thermal process of a bottoming cycle.

For new topping-cycle facilities burning natural gas or oil, however, the degree to which heat is recovered and put to use remains a concern. The final rules contain a definition of "useful thermal energy output" which eliminates the problems of the proposed terminology. Under the new definition, in the case of industrial or commercial process use of thermal energy, the thermal energy made available for use in the process may be considered useful thermal energy output of a cogeneration facility. Thus an industrial process which uses steam or heat need not be analyzed for the purpose of determining what fraction of the energy delivered to the process is actually put to use.

In the case of space heating and cooling, water heating, and related heating and cooling applications, a cogeneration facility's useful thermal energy output is the energy actually used in the application. For example, a cogeneration facility may consist of a combustion turbine with exhaust heat recovery used for space heating. In this example, the useful thermal energy output would be the heat recovered from the exhaust and actually used for space heating, not all of the heat available in the exhaust.

Paragraph (i) defines "total energy output" of a topping-cycle cogeneration facility as the sum of the useful power output and useful thermal energy output.

Paragraph (j) defines the term "total energy input" as the total energy of all forms supplied from external sources, other than supplementary firing, to the facility.

The total energy input to a cogeneration facility includes all fuels and renewable resources used in the facility. Energy taken from one part of the facility and used in another part of the cogeneration process does not meet the test of being supplied from an external source. For example, boiler feedwater pumping, heating, and de-aerating are energy uses internal to the cogeneration facility and are not to be considered as either energy inputs or energy outputs.

The Commission has added the definition of natural gas in paragraph (k) as it is defined in the Natural Gas Act, which is the natural gas unmixed, or any mixture of natural gas and

artifical gas. This is intended to cover natural gas supplied by any natural gas company as defined in the Natural Gas Act or any distribution company selling natural gas. As a result, the efficiency standards under § 292.205 only apply with respect to the natural gas so defined and do not apply with regard to any synthetic gas which is unmixed in the pipeline, or mixed by the end-user, such as coke oven gas, blast furnace gas, or gas derived from coal or shale oil.

The definition of "oil" has been added in paragraph (l) to mean crude oil, residual fuel oil, natural gas liquids, or any refined petroleum products. This definition does not include refinery-off gas, petroleum coke, or other waste products of the refinery process.

Finally, the Commission has provided in paragraph (m) that, for purposes of this subpart, in the case of energy in the form of natural gas or oil, energy input is to be measured by the lower heating value of such fuel.

In the proposed rules, energy inputs in the form of fossil fuels were to be evaluated in terms of the lower heating value of such fuels. A few commenters took issue with the use of lower heating values and recommended that higher heating values be specified in the final rule.

Lower heating values were specified in the proposed rules in recognition of the fact that practical cogeneration systems cannot recover and use the latent heat of water vapor formed in the combustion of hydrocarbon fuels. By specifying that energy input to a facility excludes energy that could not be recovered, the Commission hoped that the proposed energy efficiency standards would be easier to understand and apply. The Commission also wished to apply a standard that would be more uniform in the treatment of natural gas and oil. Owing to the difference in chemical composition, more latent, unrecoverable heat is lost in the combusion of gas as compared to oil. The Commission did not wish indirectly to make qualification more difficult for natural gas-fired cogeneration facilities by requiring a higher level of sensible heat recovery.

The commenters opposing the use of lower heating values generally argued that customary practice is to use higher

heating values. The Commission does not find this argument compelling. Both heating values of fuels can easily be found in handbooks. Moreover, if a cogenerator wishes to use the higher heating value of fossil fuels inputs for computing efficiency, the Commission has no objection. Any facility qualifying with efficiency so computed would certainly qualify under the more lenient rules set forth. As a result, the Commission does not believe it appropriate to change this aspect of the proposed rule in this final rule.

§ 292.203 *General requirements for qualification.*

The proposed rule provided that any person seeking qualifying status for a facility had to initiate discussions with the utility with which it wishes to interconnect and file an application with this Commission. The proposed rule set forth the contents of an application for certification which included technical information describing the facility, a summary of discussions required to be held between the applicant and the affected electric utility, and a description of the equity ownership of the facility. In addition, a small power producer was required to provide information about its primary energy source and its location. A cogenerator was required to submit information describing the energy input and output of the facility in both the heat engines and thermal processes.

The majority of comments favored eliminating the filing requirement either for all qualifying facilities or for specific classes of qualifying facilities. Several commenters suggested that the complexity, delays, and uncertainties created by a case-by-case qualification procedure would act as significant economic disincentive to owners of smaller facilities. Other commenters recommended exempting smaller facilities, such as facilities with an aggregate electrical capacity of up to 250 or 500 kW, from formal filing requirements. A utility[8] stated that the application procedure does not serve any party or the public's interest. This commenter preferred to see regulations

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8 Pacific Gas and Electric Company.

on an "exception" basis where the utility, State regulatory authority or other interested party could object to the granting of qualifying status.

The Commission finds substantial merit in these comments. The Commission believes the initiation of purchase and sale arrangements, pursuant to Subpart C of this part of the Commission's rules, will necessitate the flow of information between potential qualifying facilities and affected electric utilities. The Commission therefore notes that the requirements contained in the proposed rule both for discussions between a potential qualifying facility and the utility with which it wishes to interconnect and for the filing of substantial information with this Commission are not necessary.

For example, one commenter[9] suggested modifying the pre-application negotiation requirements to require that an applicant initiate discussions with the utility prior to filing if the cogenerator or small power producer is intending to negotiate an individual contract. However, if the applicant merely wants to establish his eligibility for an already-published rate schedule for qualifying facilities, this commenter claims that there would be nothing to negotiate, and thus no reason to require that discussions be held. It was asserted that notification to the utility at the time of application would suffice in such cases. The Commission believes that this is what would and should happen without any requirement from the Commission. In addition, the Commission believes that, as a practical matter, an electric utility, which is notified by a qualifying facility that it wishes to interconnect with the utility in order that the utility may purchase the power produced by the facility, will need to know the nature of the qualifying facility's expected purchases and sales so as to be able to arrange safe and reliable interconnected operation at appropriate rates.

As a result, the requirement for case-by-case qualification has been eliminated. Section 292.207(a) of this rule provides that any small power production or cogeneration facility which

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9 U.S. Department of Energy.

meets the requirements for qualification set forth in that section is a qualifying facility.

However, the Commission has provided an optional procedure in § 292.207(b) of this rule whereby an application for Commission certification of qualifying status may be filed at the discretion of the owner or operator of the facility.

There was some confusion in the comments as to who actually qualifies under this program. The facility qualifies and that entitles the owners and operators of the facility to receive the benefits of qualification under this part. The benefits of qualification under this part, however, are only with respect to the qualifying facility. For example, the owner or operator of a qualifying cogeneration facility is entitled to require the utility to sell power to his qualifying facility in compliance with the terms of § 292.305 as implemented by the State regulatory authority. The owner or operator has no entitlement to require such rate treatment for the utility's sales to other facilities he may own or operate which are not qualifying facilities. Similarly, his sales to the utility will be exempt under Subpart F of this part from certain Federal and State regulation only to the extent the sales are from a qualifying facility.

§ 292.203(a) *Small power production facilities.*

Section 292.203(a) provides that a small power production facility is a qualifying facility if it meets three criteria.

The first requirement is that the power production capacity of the facility, together with the capacity of any other facilities that use the same energy resource and are owned by the same person and are located at the same site, may not exceed 80 megawatts. The method by which the capacity is determined is described in this preamble under § 292.204.

The second requirement is that the primary energy source of the facility must be biomass, waste, renewable resources, or any combination thereof. This means that more than 50 percent of the total energy input must be in these categories. In addition, the aggregate use of oil, natural gas, and coal by the facility may not exceed 25 percent of its total energy input

during any calendar year. These fuel use criteria are discussed further in § 292.204(b).

Thirdly, a small power production facility will not be eligible for qualifying status if more than 50 percent of the equity interest in the facility is held by an electric utility or public utility holding company or any person owned by either. Section 292.206 describes this ownership test in greater detail.

One commenter raised the question as to whether a facility is included within the definition of a small power production facility in the statute, and hence the Commission's regulations, if the facility is only part of the process of producing electric energy; namely, raising steam. This commenter produces steam using municipal solid waste, which steam is then sold through an adjoining wall to an electric utility to run through a turbine and produce electricity. In a sense, this facility indirectly produces electric energy. It is unclear to the Commission how this steam-raising facility would benefit from the regulations under section 210. It is not selling electric energy to the utility; it may be buying some electric energy from the utility; and it seems unlikely that it would be subject to electric utility regulation. Therefore, the Commisson does not, at this time, see the need to allow qualification for these kinds of facilities, without judging as to whether the Commission could allow such qualification under the statute.

§ 292.203(b) *Cogeneration facilities.*

Section 292.203(b) provides that, with the exception of new diesel cogeneration facilities, a cogeneration facility may be a qualifying facility if it satisfies two requirements. First, it must meet the same ownership test as that required for a small power production facility. Secondly, it must meet any operating and efficiency standards described in § 292.205(a) and (b).

In addition, cogeneration facilities which wish to qualify for the incremental pricing exemption permitted under Title II of the Natural Gas Policy Act of 1978 (NGPA) and Part 282 of the Commission's rules must meet the requirements stated in § 292.205(c).

Section 201 of PURPA provides that "a 'qualifying cogeneration facility' means a facility which—(i) the Commission determines, by rule, meets such requirements (including requirements respecting minimum size, fuel use, and fuel efficiency) as the Commission may, by rule, prescribe . . .". Several comments contended that the statutory language *requires* the Commission to establish standards relating to all of the mentioned criteria. The legislative history of this section indicates that the phrase "as the Commission may . . ." was added in conference; it did not appear in either the House or Senate bill.[10] The plain meaning of the provision, as adopted by the Conferees, is that a qualifying cogeneration facility must meet requirements that the Commission, in its discretion, establishes. These may, but need not, include requirements respecting minimum size, fuel use, and fuel efficiency.

The Commission received numerous comments from utilities recommending that oil- and natural gas-fired cogeneration facilities not be considered eligible for qualifying status. These commenters generally argued that encouragement of such facilities would be contrary to Congressional intent and national energy policy. Comments were also received expressing strong support for the policy presented in the proposed rule, which did not impose a restriction on oil and natural gas use.

The Commission believes the policy expressed in the proposed rules is consistent with Congressional intent and national energy policy. Had Congress not intended that the benefits of qualifying status be extended to oil- and natural gas-fired cogeneration facilities, the statute or Joint Explanatory Statement of the Committee on Conference (Conference Report) would have contained a restriction on fuel use similar to that which is provided for small power producers. The Congress knew that cogeneration facilities typically use natural gas and oil. In addition, the Natural Gas Policy Act of 1978 contains an express exemption from the incremental pricing program for natural gas used in qualifying cogeneration facilities, which

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10 See Comparative Print to H.R. 4018, Public Utility Regulatory Policies Act, 72, 95th Cong., 2d Sess. (1978).

further indicates Congressional recognition that cogeneration facilities use natural gas.

Thirdly, the Congress enacted the Powerplant and Industrial Fuel Use Act (PIFUA) at the same time as PURPA. PIFUA provides authority to the Security of Energy to restrict the use of oil and gas in cogeneration facilities. Therefore, the Commission does not believe it necessary or appropriate to require an additional layer of fuel use regulation on technologies which the Commission is charged with encouraging and for which another agency has authority to restrict fuel use.

The Commission also notes that the findings in section 2 of PURPA specifically require "a program providing for . . . increased efficiency in the use of facilities and resources . . .". To the extent that oil- and natural gas-fired cogeneration facilities provide for more efficient use of these resources, the Commission believes that the benefits of qualifying status should be extended to them.

Some of the comments stated that permitting qualifying cogeneration facilities to use oil, especially in diesel engines, will use up available air quality increments, thereby preventing the conversion of large utility oil-fired boilers to coal. As noted above, the Commission believes it is not proper to address this fuel use issue within the context of this program. However, the Commission has not made a final determination regarding the environmental effects of new diesel cogeneration facilities, and is therefore including in these regulations an interim exclusion from qualification of this technology until work on an environmental impact statement has been completed.

§ 292.203(c) *Interim exclusion.*

Section 292.203(c) provides that, pending further Commission action, any cogeneration facility which is a new diesel cogeneration facility may not be a qualifying facility. A new diesel cogeneration facility is described as a cogeneration facility which derives its useful power output from a diesel engine, the installation of which began on or after March 13, 1980.

Through the issuance of these rules and the rules implementing section 210 of PURPA, the Commission intends to carry out the legislative mandate to provide encouragement to the energy technologies included within the program. The Commission is required under the National Environmental Policy Act of 1969 (NEPA) to take the environmental effects of this encouragement into account. The Commission has circulated and received public comment on a preliminary Environmental Assessment (EA) of these rules which was issued October 19, 1979. (See Appendix I)

Environmental Findings

The identification of the environmental effects associated with a "major Federal action"[11] is not ordinarily a difficult task. These effects typically are those associated with the construction and operation of a particular project in which the Federal government is playing a major role, such as by funding or licensing. In contrast, these rules and the rules implementing section 210 of PURPA do not authorize or fund any particular projects; moreover, they do not authorize or forbid the use of certain fuels. Instead, they provide certain economic incentives to, and remove other disincentives (*i.e.*, assurance of a market for electrical production and exemption from utility regulation) from certain classes of technologies. It is important to note that, even without these rules, these technologies have been, and would continue to be, utilized. The environmental effects associated with this "base-case" level of development cannot be ascribed to these rules. Instead, the proper way to isolate and identify the effects of these rules is to predict the "base-case" (no PURPA) level of development, and determine the environmental effects of that level of development, and compare it to the effects of the projected development with these rules in place. Under this approach, any changes from the base-case review are properly classified as effects of these rules.

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11 Section 102(2)(c) of the National Environmental Policy Act of 1969, Pub. L. 91-190.

The first step used in determining the environmental effects of these rules was to compare, by region, representative electric utility rates with the cost of generating electricity by use of a qualifying facility. This comparison established which technologies would be economically viable. Next, the costs of generating electricity by the facility were compared to an estimate of utilities' avoided costs on a regional basis. If, by receiving the avoided cost for its output, a facility would operate economically, it was considered to have been "PURPA-induced." Avoided costs is the maximum price inducement under this program.

For technologies which would, as a result of PURPA, be economic, regional levels of market penetration were established on the basis of site availability and manufacturing capability. Finally, the environmental effects associated with the predicted level of development were calculated.

The Environmental Assessment accompanying this order describes the environmental effects associated with all of the types of technologies encompassed in section 201 of PURPA. The quantitative effects associated with the predicted market penetration of each technology were then estimated.

The Environmental Assessment includes an extensive market-penetration analysis of each technology eligible for qualification under the Commission's proposed rules and of the aggregate of all of these technologies. Since the proposed rules took the broadest view of which technologies would be eligible for qualification, the analysis covers all technologies, which, under the statute, may be eligible for qualification. On the basis of this analysis, the Commission has estimated the amount of capacity expected to be induced on a regional and national basis through January 1, 1995, assuming the broadest implementation of this program.

This analysis shows that this program may result in the construction of 12,000 MW of new capacity by qualifying facilities by 1995, and the reduction in utility construction of 10,000 MW of new capacity. It also indicates a possible fuel savings in 1995 of 40,000 bbl/day of oil, 40,000 bbl/day equivalent of natural gas, and 120,000 bbl/day equivalent of

coal, as the use of renewable resources increases, and more efficient use is made of both renewable and non-renewable resources.

The Environmental Assessment finds that there will be both adverse and beneficial environmental effects associated with this program. Some of the technologies produce certain air emissions, water effluents, and other environmental effects. However, material and thermal by-products of industrial, commercial, agricultural and other activities that would otherwise contribute to environmental degradation will be consumed or otherwise utilized in the production of useful energy under this program.

In addition, the Environmental Assessment indicates that utilities will be able to defer or cancel construction of certain facilities, originally scheduled for construction between 1980-1995. These deferrals or cancellations are expected to include some eleven 500 MW coal-fired steam plants, one 1,000 MW nuclear plant, a number of 75 MW gas turbines, and certain large scale hydropower and combined cycle installations. The environmental impacts associated with the construction and operation of these facilities would be avoided.

Finally, the market-penetration analysis in the Environmental Assessment indicates that the incentives provided by this program will not significantly affect the development of some technologies while they will significantly encourage others. For example, it appears that this program will significantly encourage small hydroelectric power development. Water power project impacts are usually site-specific and localized, with no cumulative impact on a national basis, and few impacts of regional significance. The Commission notes that hydroelectric projects in almost all cases must be licensed by the Commission. License applications are evaluated on a case-by-case basis to determine the significance of the environmental impacts and the need for a site-specific EIS. In addition, impacts of individual projects on a waterway may be cumulative, and the Commission reviews each project in relation to others on the waterway under the "comprehensive development" standard of section 10(a) of the Federal Power Act. Therefore, even

though only the general nature of the kinds of environmental effects can be evaluated in this programmatic environmental assessment of national scope, requirements of the National Environmental Policy Act of 1969 (NEPA) will be met as each application is filed.

For certain other technologies, the level of environmental effects associated with the PURPA-induced market penetration of these technologies will not approach a significant level in the near term.[12] The Commission will monitor the PURPA-induced market penetration of these technologies carefully.

In the public comments, evidence was presented indicating that the environmental consequences of qualifying new diesel cogeneration may be significant in the near term, in certain geographic areas, even with a moderate level of market penetration. Therefore, the Commission believes that it is appropriate to delay action on qualification of new diesel cogeneration until completion of an EIS. The Commission will circulate a draft EIS within the next month and conclude its analysis within 90 days of circulation.

The Commission acknowledges the difficulties in identifying the levels of the environmental effects associated with the programmatic encouragement and deregulation of various types of technologies as are present under this program. There are, of course, a great number of uncertainties in any such analysis. However, the Commission is required under NEPA to assess these effects to the fullest extent possible.

On the basis of its environmental review, the Commission has made the following findings in its Environmental Assessment:

—The program, taken as a whole, will not have a significant impact on the quality of the human environment within the meaning of section 102 of NEPA. The Commission also has noted certain beneficial environmental impacts that may result from this program.

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12 See Figures 3 through 7 in the Environmental Assessment.

—Where the expected market penetration of technologies which could qualify under this program is not expected to cause any significant environmental effects in the near term, the Commission will allow qualification of these technologies without delay.

—Where a technology is expected to cause significant environmental effects in the near term, an EIS covering the technology will be prepared and considered before the Commission acts on qualification.

—The Commission is establishing a monitoring program to alert the Commission to the likelihood or extent of market penetration by technologies which qualify under this program. This is designed to produce information that may be relevant to taking appropriate environmental protection action in the future before the program reaches a stage of investment or commitment to implementation likely to determine subsequent development or restrict later alternatives.

§ 292.204(a) *Criteria for qualifying small power production facilities.*

Section 292.204 sets forth qualification requirements for small power production facilities. Paragraph (a) implements the statutory requirement that the power production capacity of a small power production facility not exceed 80 megawatts at any site. In order to implement this limitation, the proposed rules provided that the capacity of all facilities which use the same energy resource, are owned by the same person, and are located within one mile of each other be added together. Commenters recommended eliminating the site criterion because the important criterion is not siting but that facilities use alternate energy resources. Commission recognizes the difficulty in prescribing site criteria for purposes of calculation of the size of the facility, the Commission is obligated under the statute to limit qualifying status for small power production facilities to those facilities which have "a power production

capacity which, together with any other facilities located at the same site (as determined by the Commission), is not greater than 80 megawatts."[13]

In subparagraph (2)(i), the Commission defines "facilities located at the same site" as facilities located within one mile of the facility for which qualification is sought. Hydroelectric facilities (within this distance) are considered to be located at the same site only if the facilities use water from the same impoundment for power generation. The Commission views this additional provision for hydroelectric facilities as necessary because use of the one-mile rule alone might discourage the development of facilities on separate waterways which are within one mile of each other or of closely-spaced impoundments on an individual stream.

The Commission also notes that in some instances hydropower resources may be developed without an impoundment. In this case, the one-mile rule would be the only factor in determining the size of a facility.

In response to comments, the Commission has added subparagraph (2)(ii) which requires, for purposes of determining the distance between facilities, that any measurement shall be made from the electrical generating equipment of a facility. The comments noted that some facilities may include equipment for gathering energy to be used in the facility which may extend up to a number of miles from the generating facility. The Commission believes that the one-mile limit should be measured from the generating facilities.

The proposed rule enabled an applicant to rebut the presumption that facilities located within one mile of the facility for which qualification is sought, using the same energy resource and owned by the same peson, should be considered to be located at the same site. The Commission believes that the requirement to rebut the presumption was burdensome and confusing. Therefore, the final rule has been revised to enable a small power producer or cogenerator to apply to the Commission for a waiver for good cause.

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13 Section 3(17)(A)(i) of the Federal Power Act.

The proposed rule also contained a minimum size limit of 10 kW for qualification of small power production facilities. This proposal was based on the Commission's view that facilities smaller than 10 kW were unlikely to be economically viable, and that the administrative burden of arranging interconnected operation with them would be greater than the benefits they would provide to the system at this time. This proposal attracted considerable comment, both at the public hearings and in written recommendations. The majority of the comments objected to the minimum size provision and indicated that a number of facilities smaller than 10 kW are being built and that some units are presently commercially available. Commenters also stated that these facilities can be equipped with electrical protection equipment which permits safe interconnected operation.

Several utilities, on the other hand, suggested raising the minimum size limit, arguing that small facilities are not cost-effective. The Commission notes that the rules implementing section 210 of PURPA (Subpart C of this part) require that standard rates be provided for facilities up to 100 kW. Those rules together with the self-qualification provisions of these rules greatly ease the administrative burdens on all parties. The Commission also notes that the rules implementing section 210 of PURPA require that a qualifying facility is obligated to pay any interconnection costs assessed against it by the State regulatory authority or nonregulated electric utility. Since under these rules the utility is not obligated to incur any additional costs by reason of interconnected operation with these facilities, the minimum size limitation has been eliminated to allow individual decisions to govern whether or not to install these very small facilities.

§ 292.204(b) *Fuel Use.*

Paragraph (b) sets forth fuel use requirements for qualifying small power production facilities. In the proposed rule, the term "primary energy source" was not defined. Several commenters noted this fact and asked that the final rules specify a

definition for the term. Subparagraph (1) provides that the primary energy source of the facility must be biomass, waste, renewable resources, or any combination thereof, and more than 50 percent of the total energy input must be from these sources. The Commission notes that this requirement is not intended to force small power producers to continually monitor the energy input, but rather that reasonable estimates based on sampling methods are sufficient.

Qualifying small power facilities using biomass as a primary energy source are treated differently then [sic] are facilities using other resources for purposes of exemption from the Public Utility Holding Company Act and certain State law and regulation section 210(e) of PURPA and under § 292.602 of the Commission's regulations. A further concern in determining a facility's primary energy source is the treatment of mixtures of biomass and waste or renewable resources. Therefore, in subparagraph (1), the Commission specifies that any primary energy source which, on the basis of its energy content, is more than 50 percent biomass shall be considered biomass. In other words, a qualifying facility may be considered biomass-fired if, on an estimated annual basis, at least half the energy input, exclusive of fossil fuel use, is biomass.

The Commission expects that this rule will extend the benefits of the biomass exemption provisions to a broad range of facilities. For example, evidence presented in this rulemaking indicated that much more than half of the energy content in municipal solid waste is due to "organic material not derived from fossil fuels," or "biomass" under the Commission's definitions. Thus, a small power production facility fired with municipal solid waste may be considered a biomass facility. The same treatment applies to facilities fired with forest-industry residues, sewage sludge, or peat.

Another aspect of what constitutes "primary energy source" is a specification of what fuels may be used in addition to the primary energy source for purposes of ignition, startup, testing, flame stabilization and control, and during equipment outages and emergencies.

Section 3(17)(B) of the Federal Power Act, as amended by section 201 of PURPA, provides that:

> " 'primary energy source' means the fuel or fuels used for the generation of electric energy except that such term does not include, as determined under rules prescribed by the Commission, in consultation with the Secretary of Energy—
>
> "(i) the minimum amounts of fuel required for ignition, startup, testing, flame stabilization, and control uses, and
>
> "(ii) the minimum amounts of fuel required to alleviate or prevent—
>
> "(I) unanticipated equipment outages, and
>
> "(II) emergencies, directly affecting the public health, safety, or welfare, which would result from electric power outages."

The proposed rule set forth limits for the allowable use of fossil fuels. Three separate standards were proposed: one for ignition, startup and testing; another for flame stabilization and control; and a third for fuel use during outages of the primary energy supply system. All of the proposed standards were set in terms of barrels of oil per year per megawatt of rated capacity.

The comments filed on this section generally favored less restrictive fossil fuel limitations. Several commenters noted that standards written in terms of barrels of oil were imprecise, since the energy content of a barrel of oil is not constant. Other commenters argued that separate standards for startup, flame stabilization and outages were unnecessarily burdensome. Commenters claimed that some small power production technologies would be severely constrained by one of the standards, while requiring little or no fossil fuel for other purposes. Additionally, to the extent oil and natural gas remain more expensive than other energy sources available to small power producers, there is an economic disincentive to use oil

and natural gas. Thus it was argued that a single standard for allowable fossil fuel use would be more equitable and workable when dealing with a number of types of facilities. The Commission has decided to adopt this recommendation.

Many other commenters recommended that the Commission adopt alternative amounts of fossil fuel for use during outages and for other purposes. For the purpose of specifying the minimum amounts of fuel under clauses (i) and (ii) of section 3(17)(B) of the Federal Power Act, the Commission adopts in this rulemaking the standard, recommended by several commenters, that no more than 25 percent of the total energy input during any calendar year may consist of fossil fuels—namely oil, natural gas, and coal.

With this simple rule, a qualifying facility can use up to the allowed quantity of fossil fuel for purposes specified in the statute. No question remains concerning what sort of primary fuel system supply outages are within the scope of the rule. The standard does require that a small power producer be able to estimate the energy content of the primary energy source. The Commission recognizes that for some energy sources, municipal solid waste in particular, energy content is not constant. As has been stated earlier, the Commission believes that reasonable estimates will suffice for purposes of this rule. Finally, it should be noted that the fossil fuel limitation applies only to small power production facilities. Some commenters apparently regarded the limitations as equally applicable to cogeneration facilities. This is not the case.

Another issue raised by the proposed rule was the limitation of renewable resources to water used at existing dams. Commenters urged the Commission to expand the definition of renewable resources to include water used at new hydroelectric facilities. The Commission has reviewed the Conference Report and has determined that the Conferees did not intend to restrict the term renewable resources to water used only at existing dams. The Commission believes that such an interpretation conflicts with the conventional use of the term "renewable resources" as including all hydroelectric sources, not just those using existing dams. Therefore, the Commission intends

that the term renewable resources applies to water used at existing and new hydroelectric facilities of less than 80 megawatts.

§ 292.205 *Criteria for qualifying cogeneration facilities.*

§ 292.205(a)(1) *Operating standards for topping-cycle cogeneration facilities.*

In its Notice of Proposed Rulemaking, the Commission recognized the problem of distinguishing cogeneration facilities which achieve meaningful energy conservation from those which are merely "token" facilities, producing trivial amounts of either useful heat or power. In the proposed rules, the *bona fide* character of a facility was to be determined by minimum amounts of useful heat and power output.

The need for operating standards as a means of identifying *bona fide* cogeneration facilities drew considerable comment. Some comments indicated that this formulation had the effect of imposing energy efficiency requirements which are not appropriate for some technologies. Commenters stated that a much simpler test than the proposed standards would be adequate for the task. Two commenters suggested a simple test regarding the portion of energy developed in the form of useful heat or steam. One potential qualifying facility[14] suggested that:

> for geothermal energy cogeneration facilities, the energy utilization by the non-electric processes must average on an annual basis at least 5 percent of the energy consumption of the heat engine.

Another commenter suggested "a minimum of 10% of the total steam generation must be used as steam send-out."[15]

Generally, commenters did not oppose a requirement for distinguishing a *bona fide* cogeneration facility from essentially

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14 Republic Geothermal, Inc.

15 Raytheon Corporation.

single purpose facilities, even while taking exception to the form and substance of the proposed efficiency standards. One commenter[16] stated:

> A significant portion of the steam, heat or energy available from the cogeneration unit should be used in an industrial, commercial, heating or cooling applications. The concept of an operator of a large thermal generating station applying condensing techniques taking a tiny side stream out to heat a tool shed so that cogeneration could be claimed should be prohibited.

The Department of Energy[17] recommended the inclusion of a requirement that some minimal fractions of useful heat and power be produced.

Consequently, the Commission has decided that a simple means of identifying *bona fide* cogeneration facilities is appropriate. The *bona fide* test has been modified to specify only that a minimum proportion of the useful energy output be useful thermal energy output without regard to the energy input. The standard requires that at least 5 percent of a qualifying cogeneration facility's total energy output be in the form of useful thermal energy output. Compliance with this standard is to be based on estimated annual energy output.

Further, this basic *bona fide* test is applicable only to topping-cycle facilities. "Tokenism" is of concern for bottoming-cycle facilities chiefly with regard to the opportunity for qualifying facilities to obtain exemption from incremental pricing under the Natural Gas Policy Act. Natural gas used by bottoming-cycle facilities (other than in supplementary firing) will, as a general matter, be exempt from incremental pricing only to the extent that reject heat is utilized in power production. In view of these provisions, no separate *bona fide* test is necessary.

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16 This commenter, Potlatch Corporation, proposed as a test that at least 25 percent of the steam, or useful energy, available be applied on an annual basis in industrial, commercial, heating or cooling uses.

17 The Economic Regulatory Administration.

§ 292.205(a)(2)(i) *Efficiency standards for topping-cycle facilities.*

The proposed rules set forth efficiency standards for oil- and gas-fired topping-cycle cogeneration facilities. The efficiency standards were composed of three separate criteria. The first criterion required, in effect, that no less than 20 percent of the energy input to the facility be converted to mechanical or electrical power. The second criterion specified that 45 percent of the heat rejected from the heat engine (a term used in the proposed rule to describe the power production process) be put to use in a thermal process. The final criterion required at least 60 percent of the energy input to the facility to be used either as power or useful heat.

Comments on the proposed efficiency standards criticized both their form and substance. Many commenters stated that the 20 percent efficiency criterion for heat engines was overly restrictive. These commenters pointed out that most steam turbines would not be able to meet the standard with conventional steam inlet and exhaust pressures. Many such steam turbine cogeneration systems would represent energy efficient systems when compared to the standard practice of separate steam and electricity production.

Fewer comments were directed toward the efficiency tests concerning heat recovery and overall efficiency. The comments that were made, however, indicated a need for revision. One commenter indicated that the heat recovery standard would exclude diesel-powered cogeneration facilities even though many such facilities would be highly energy efficient. Comments on the overall efficiency standards were mixed. One commenter suggested that the standard was too lenient. Another commenter recommended that the proposed 60 percent test be reduced to 50 percent, although this commenter appeared to be principally concerned with the application of efficiency standards to the use of renewable resources and not to the use of scarce fuels.

Five commenters addressed the question of efficiency standards for oil- and natural gas-fired cogeneration in a compre-

hensive manner by proposing a complete set of alternative standards. Four of these five commenters advanced proposals based on energy balance criteria, similar in theory to the proposed standards. A proposal by the New York State Energy Office closely resembled the proposed rule. Under this plan, individual tests for heat engine efficiency, heat recovery, and overall efficiency would still be required. The overall efficiency test would remain at 60 percent, but the heat engine and heat recovery tests would be reduced to 10 percent. This was the only comment in favor of maintaining separate efficiency standards for power production and heat recovery. The criticism of that scheme has caused the Commission to adopt an alternative efficiency standard which better takes into account the variety of technologies which qualify under this rule. The essential issue concerns the proper level of the overall efficiency standard which should be applied in individual cases.

Three commenters proposed efficiency standards relating solely to overall efficiency. A utility[18] recommended a single standard of 50 percent overall efficiency, which was the most lenient standard suggested. This proposal, furthermore, would be related to design efficiency and not actual or estimated operating efficiency. Another commenter[19] recommended a single standard of 65 percent overall efficiency. This standard would be slightly stricter than the first proposal discussed for all facilities except those producing predominantly either electricity or heat. Finally, the Commonwealth of Massachusetts Office of Energy Resources proposed a standard which would weight thermal energy with only half the value of electricity.

The latter two comments are both supported by well-reasoned examples of cogeneration engineering practice. The Massachusetts proposal is relatively more stringent for facilities producing more heat than electricity, and more lenient for facilities producing much of their output as electricity. The basis for this proposal is a comparison of cogeneration systems based on steam turbine, combustion turbine, and diesel engine

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18 Brooklyn Union Gas Company.

19 Mechanical Technology Incorporated.

prime movers with oil-burning non-cogeneration technology. Essentially, it is argued that any cogeneration facility meeting the proposed efficiency standard will be more efficient than any combination of separately generated electricity and steam using efficient, state-of-the-art technology. By requiring that the sum of useful power output and one-half the useful thermal output be greater than 45 percent of the facility's energy consumption, this proposal would ensure that qualifying facilities produce heat and power more efficiently than a [sic] 8500 Btu/kWh combined cycle generating station and a 90 percent efficient process steam boiler.

Moreover, this proposal appears to impact the various cogeneration technologies more equitably than the other proposed standards. The other proposals for required overall efficiency, by simply summing heat and power on an equal basis, make qualification relatively easy for steam turbine systems which produce little electricity. Cogeneration systems which produce high ratios of electricity to heat would be penalized with difficult heat recovery requirements. Yet the systems with high electricity to heat ratios have the highest "second law" energy efficiencies. Furthermore, a standard which is relatively lenient towards oil- and natural gas-fired steam cogeneration would encourage boiler fuel use of distillate oil and natural gas.

The proposal of another commenter, although considered in detail, would impact different cogeneration technologies differently and would not give assurance of energy conservation.[20]

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20 The efficiency standard proposed by this commenter, the American Paper Institute, differed from all others fundamentally in that an effective heat rate test was required. A qualifying cogeneration facility was defined as:

> A cogeneration facility that for the electric energy produced incrementally to steam or useful energy production:
>
> 1. uses less than 9,000 BTU of additional fuel per kilowatt hour and
>
> 2. produces more electric energy than it consumes
>
> and that at least twenty-five percent of the steam, or useful energy, available is applied on an annual basis in industrial, commercial, heating or cooling uses.

In light of the foregoing considerations, the Commission has decided to adopt a standard in paragraph (a)(2)(i) similar to that proposed by the Massachusetts Office of Energy Resources as its standard for efficiency of new oil- and natural gas-fired topping-cycle cogeneration systems. This standard requires that for any topping-cycle cogeneration facility for which any of the energy input is natural gas or oil and the installation of which began on or after March 13, 1980,[21] the useful power output plus one-half the useful thermal energy output of the facility must be, during any calendar year, no less than 42.5 percent of the energy input of natural gas and oil to the facility. The Commission adopted a value of 42.5 percent, rather than the 45 percent recommended by the Massachusetts comments because, in the Commission's view, the 45 percent requirement appears overly restrictive for steam turbine cogeneration facilities in that very high boiler efficiencies would have been required. However, if the useful thermal energy output of any such facility is less than 15 percent of its total energy output, the useful power output plus one-half the useful thermal energy output of the facility must be no less than 45 percent of the total energy input of natural gas and oil to the facility.

Existing Versus New Cogeneration Facilities

Although the Commission has found a compelling reason to impose efficiency standards on new oil and gas burning cogeneration facilities, the situation with respect to existing facilities is different. Existing facilities are those for which the installation of the cogeneration equipment began before the

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21 The preamble discusses new versus existing facilities. This is expressed in the regulations as "facilities, the installation of which began on or after March 13, 1980," or before that date. The Commission views the beginning of installation as the beginning of physical modification of the site or of pre-existing facilities. Of course, any sharp line will create its own inequities and raise its own questions. The waiver provision of § 292.205(d) is available to redress those inequities, and the optional procedure for qualification under § 292.207(b) is available to answer those questions.

Commission actions encouraging cogeneration under this program were finalized. Presumably, such facilities would continue to be installed or operated using whatever fuels they are equipped to burn, with or without the incentives of PURPA.

Allowing existing facilities to qualify will provide for more flexible operation of the facilities. Optimum efficiency of a cogeneration facility may be more easily approached through interconnected operation with an electric utility. Because of the foregoing considerations, denial of qualifying status would serve no useful purpose.

Existing cogeneration facilities burning oil or natural gas were, in large measure, installed in an environment of lower fuel prices. Such facilities may not be able to meet the higher standards now reasonable for use of scarce fuels. Yet failure to meet standards intended for new facilities should not preclude entitlement to sell power to the utility and to receive the other rate benefits, as provided under Subpart C of these rules. In addition, the denial of exemption from regulation as an electric utility may discourage cogeneration at existing facilities.

The Commission has decided against imposing any efficiency standards on existing facilities, regardless of energy source. There is no assurance that imposing standards would result in fuel savings. The opposite result is more likely, if operating cogeneration facilities are denied the benefits of interconnected operation with an electric utility. Therefore, for any cogeneration facility, the installation of which began before the date the Commission's final rules in this docket were issued, March 13, 1980, no efficiency standards are required for qualification, regardless of energy source or whether it is a topping or bottoming-cycle facility.

Efficiency to be Based Upon Projected Annual Operation

Several commenters raised the issue of whether efficiency calculations should be based on rated performance characteristics or on expected performance over a period of time. Only half of the commenters that mentioned the issue took a

position in favor of one means of computation or another. The balance of the commenters merely asked for clarification.

The Commission is persuaded that the efficiency of a cogeneration facility operating at peak production of power and heat may not necessarily correlate with the efficiency which can be practically realized. A cogeneration facility which serves a highly variable heating load may seldom be operated at peak efficiency. The efficiency standards required for new oil or natural gas cogeneration facilities are intended to assure efficient use of these premium fuels. Use of optimum or design basis circumstances for determining efficiency would not satisfy the Commission's concern. A computation based upon projected or estimated annual operations will more closely reflect the facility's actual energy conservation potential.

The Commission realizes that estimates will be required in order to determine the efficiency of a facility not yet constructed. The Commission believes, however, that such estimates would routinely be performed prior to any decision to invest in cogeneration equipment. No significant burden is therefore expected in determining a cogeneration facility's qualifying status.

Why the Efficiency Standard Based on "Effective Heat Rates" Was Not Adopted

Evaluating the performance of a cogeneration facility in terms of the quantity of additional fuel used per kilowatt hour of electricity generated, above that needed for heating purposes alone, results in a standard known as the "effective heat rate."[22] This form of efficiency evaluation has been widely used

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22 To compute a cogeneration facility's effective heat rate, an assumption is made that the thermal output of the facility would have to be supplied in any event. A certain quantity of fuel would be needed to satisfy the thermal load in the absence of cogeneration. For example, if a steam turbine topping-cycle cogeneration facility were not installed, a conventional steam boiler would raise the steam. With the topping-cycle system, slightly more fuel is burned to raise steam at a higher pressure than is needed for the thermal process. The steam is expanded in a turbine, generating electricity and exhausting steam at the proper pressure for the thermal process. Effective heat rate is computed by dividing the extra energy supplied to the facility by the electricity generated.

to compare cogeneration of electricity to conventional utility generation. For a typical backpressure steam turbine cogeneration facility the effective heat rate of electricity generation may be as low as 4500 BTU/kWh — twice the efficiency of central station utility generation.

The effective heat rate test has some serious drawbacks, however. The test looks only to the efficiency of electricity generation and ignores the balance of the cogeneration facility. While the effective heat rate of a topping turbine may be high, if only a small fraction of the energy produced is in the form of electricity, the overall system is essentially a boiler facility, and the aggregate energy conserved is minimal. Indeed, effective heat rates are most favorable for systems which produce little electricity and a large amount of steam. The effective heat rate is lower for combustion turbine and internal combustion cogeneration, as compared to steam, but such systems produce more electricity per unit of fuel used. When the efficiency of the entire system is computed in such a manner as to credit the quality as well as quantity of energy produced[23], combustion turbine and internal combustion cogeneration systems consistently score higher than steam systems. Thus the effective heat rate test does not truly measure overall system efficiency, and is not an adequate measure of whether, in the aggregate, energy is conserved through cogeneration.

§ 292.205(a)(2)(ii) *Topping-cycle facilities using energy sources other than oil or natural gas.*

In the final rule, the Commission has decided not to impose efficiency standards for qualification of topping-cycle cogeneration facilities using energy sources other than oil or natural gas. The proposed rules contained standards for topping-cycle cogeneration facilities using energy sources other than coal or coal-derived fuels. The efficiency standards were

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23 A Btu of electricity, for example, is worth more than a Btu of low pressure steam. The steam may be used for heat, but it is not useful for lighting or operating a television set. The "Second Law Efficiency" concept accurately reflects the usefulness of various forms of energy.

proposed in response to two concerns. First, some energy sources may be viewed as limited in access. Use of such resources by one cogenerator deprives another, possibly more efficient cogeneration facility, of the opportunity to use the resource. Efficiency standards were proposed in order to ensure that the first cogenerator, to gain access to the resource, would build an efficient facility in the absence of an effective market for the resource.

The second concern dealt with a means of distinguishing a *bona fide* cogeneration facility from a small power production facility with incidental recovery and use of steam or heat. The Commission believed that some means was necessary to prevent small power production facilities from evading the statutory size limits. A standard setting forth minimum production of power and minimum recovery of heat was seen as a means of avoiding the qualification of "token" cogeneration facilities.

Neither concern is, however, relevant to the use of coal as a primary fuel. Coal is not characterized by limited access and it cannot be used as a primary fuel by small power production facilities. Therefore, the proposed rule contained no efficiency standards for facilities fueled by coal.

Most commenters addressing this question stated that the proposed standards were impossible to meet in many instances. More importantly, commenters questioned the basic rationale of applying efficiency standards. The limited access concept is complex, and some commenters missed the point, arguing that such resources are renewable or available in large quantity.

EPA pointed out that the degree to which limited access may affect the sort of facility constructed is unknown. The effects of limited access, if any, are likely to be site specific, and will vary with time. Even if these effects could be spelled out with certainty, the specification of appropriate efficiency criteria would be a difficult task at best. If a standard of thermal efficiency were set without detailed knowledge of both the technologies and patterns of resource development, the probable effect would simply be to stifle development of the resource.

The Commission concludes that the proposed cure is far worse than the suspected ailment. In addition, as we stated in the discussion addressing the operating standards, the 5 percent minimum amount of useful thermal output standard will assure that these facilities are *bona fide* cogenerators under these rules.

§ 292.205(b) *Efficiency standards for bottoming-cycle facilities.*

The proposed rule contained a two-part efficiency standard for bottoming-cycle cogeneration facilities. All facilities, except those using coal or coal-derived fuels, would have been required to meet the standards. The first part of the efficiency standard dealt with the heat engine. In order to qualify, a facility had to either convert 15 percent of the reject heat from the thermal process to mechanical energy, or in the alternative, achieve 40 percent of the ideal Carnot efficiency with the working fluid temperatures experienced. The second part of the standard simply required an overall energy efficiency of 60 percent for the entire facility.

Numerous commenters were critical of the proposed standards. Although a number of issues were addressed, a common concern was the counter-productive nature of efficiency standards for bottoming-cycle cogeneration facilities relying on reject heat. It was argued that because the heat would otherwise be wasted, efficiency standards would serve no fuel conservation purpose. The only effect of efficiency standards would be a limitation on the number of bottoming-cycle facilities which would be constructed.

Moreover, many commenters noted that the overall energy efficiency standard of 60 percent was overly restrictive, and in fact meaningless in many instances. The overall energy efficiency, as defined in the proposed rule, would be determined by the efficiency of the bottoming-cycle heat engine and the efficiency of the industrial thermal process. Typically the latter efficiency is predetermined by the nature of the process and the design of the industrial plant. When bottoming-cycle cogenera-

tion equipment is added to an existing plant, the efficiency of that plant's energy utilization is irrelevant to the effectiveness of the bottoming cycle. Furthermore, the measurement of overall energy efficiency required under the proposed rules would be difficult, since such efficiency measurements are not a conventional practice.

The Commission recognizes the validity of these comments, and has therefore eliminated efficiency standards for most bottoming-cycle cogeneration facilities. The final rule contains an efficiency standard for only those facilities with oil or natural gas supplementary firing. The need for standards in this case was acknowledged by several commenters.

When supplementary firing is used in a bottoming-cycle cogeneration facility, more than reject heat is used to generate electricity. Scarce fossil fuels can be introduced without the inherent efficiency advantages of sequential use. In order to restrict the potential for abuse, the Commission has adopted a simple efficiency test similar to that suggested by one of the commenters. The standard relates only to facilities installation[24] of which began on or after March 13, 1980, and for which any of the energy input as supplementary firing is oil or natural gas. Paragraph (b)(1) specifies that the useful power output of the bottoming cycle must, during any calendar year, be no less than 45 percent of the energy input of natural gas and oil for supplementary firing. The Commission notes that the fuels used in the thermal process "upstream" from the bottoming-cycle facility's power production system are not considered in this efficiency test. The use of the lower heating value, consistent with the proposed rules, is advantageous to cogenerators in that the latent heat of combustion water cannot be effectively recovered by any practical bottoming-cycle technology currently forseeable.

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24 In the case of bottoming-cycle cogeneration in which electric generating equipment is retrofitted to existing sources of industrial reject heat, the date at which installation begins is the date on which the retrofit is begun.

§ 292.205(c) *Exemption from incremental pricing.*

One of the incentives for cogeneration is found not in PURPA but in the Natural Gas Policy Act of 1978 (NGPA). In section 206(c), the Commission is given the discretion to exempt qualifying cogeneration facilities from its incremental pricing program developed under Title II of the NGPA.

On September 28, 1979, the Commission issued final rules implementing the incremental pricing provisions of the Natural Gas Policy Act of 1978.[25] These rules provide, among other things, that natural gas used by "a qualifying cogeneration facility" shall be exempt from the incremental pricing provisons of the NGPA.[26] A qualifying cogeneration facility is defined in the regulations as a cogeneration facility which meets the requirements prescribed by the Commission pursuant to section 201 of the Public Utility Regulatory Policies Act of 1978 (PURPA).[27]

In this paragraph, the Commission has set forth the requirements for exemption from incremental pricing. Paragraph (c)(1) allows that any topping-cycle cogeneration facility which is a qualifying facility under § 292.203(b), and, if not already required to do so, meets the operating and efficiency standards under paragraphs (a)(1) and (2)(i) of this section, or is a qualifying facility under Subpart E of this part, may obtain an exemption from incremental pricing for its natural gas use.

Paragraph (c)(2) enables natural gas used in bottoming-cycle cogeneration facilities and which is not exempt from incremental pricing under Subpart E of this part to obtain exemption under this subpart to the extent that reject heat emerging from the useful thermal energy process is made available for use for power production. The Commission feels that these requirements adequately reflect the goal of PURPA to encourage the efficient use of energy by cogeneration facilities. To the extent

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25 18 C.F.R. Part 282, 44 Fed. Reg. 57226 (Oct. 5, 1979).

26 18 C.F.R. § 282.201(a).

27 18 C.F.R. § 282.202(e).

that a facility makes available its reject thermal energy to produce power, the Commission believes it should obtain the benefit of exemption from incremental pricing.

The Commission does not intend for this subpart to interfere with any exemptions provided under Subpart E. Therefore, paragraph (c)(3) provides that any person who obtained an exemption under Subpart E is not affected by this provision.

Paragraph (c)(4) provides that natural gas used for supplementary firing in any cogeneration facility is not eligible for exemption from incremental pricing under this subpart. However, natural gas used for supplementary firing of a bottoming-cycle facility would be exempt under the Commission's Order No. 49-A, to the extent that the facility generates electricity which is sold to a utility.[28]

When the final regulations under Phase II of incremental pricing take effect and the Commission can then better assess their implications, the Commission may wish to revise the exemptions from incremental pricing granted to cogeneration facilities, including the exemption provided in the Interim Rule under Subpart E.

§ 292.205(d) *Waiver.*

This paragraph provides that the Commission will consider waiving any of the standards described above upon a showing that the facility will produce significant energy savings.

§ 292.206 *Ownership criteria.*

Section 292.206 is designed to implement the statutory requirement that a qualifying small power production facility or cogeneration facility must be owned by a person not primarily engaged in the generation or sale of electric power (other than electric power solely from cogeneration facilities or small power production facilities). Regarding this provision, the Commission notes that the Conference Report states that:

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[28] See Order No. 49-A, issued December 27, 1979, in Docket No. RM79-14, 45 Fed. Reg. 21 (Jan. 2, 1980).

> [e]lectric utilities may participate in an entity which owns such (qualifying small power production or cogeneration) facilities with other persons, and such entity could qualify under these definitions.
>
> The test of this case is whether the entity which owns the facility is primarily engaged in the generation or sale of electric power other than in connection with its ownership of the cogeneration facilities or small power production facilities.[29]

Thus, either directly or through a subsidiary company, an electric utility could participate in the ownership of a qualifying cogeneration or small power production facility.

Several commenters noted that under a literal interpretation of the Conference Report's statement, several electric utilities could form a subsidiary which owned small power production or cogeneration facilities. Such a subsidiary would constitute an entity which is not primarily engaged in the generation or sale of electric power other than in connection with its ownership of cogeneration or small power production facilities. Under such an interpretation, the subject facilities would be eligible to receive qualifying status.

The Commission believes, however, that the thrust of section 201 of PURPA is to limit the advantages of qualifying status to cogeneration and small power production facilities which are not owned primarily by electric utilities or their subsidiaries. The proposed rule provided that if, based on the proportion of ownership by electric utilities, public utility holding companies, or subsidiaries of either, more than 50 percent of the entity which owns the cogeneration or small power production facility is comprised of these electric utility interests, then the facilities are not qualifying facilities. This language has been incorporated into these final rules; the comments on this section provided no sufficient reasons in the Commission's judgment for changing the percentage.

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[29] Conference Report on H.R. 4018, Public Utility Regulatory Policies Act of 1978, H. Rep. No. 1750, 89 95th Cong., 2d Sess. (1978).

The Commission emphasizes the fact that nothing in this program limits the extent of utility ownership or operation of cogeneration or small power production facilities. The Commission notes the statement in the Conference Report that:

> . . . it is also the intention of the conferees that the definition of "qualifying cogeneration facility" and "qualifying small power production facility" will not be construed as prohibiting or discouraging electric utilities from cogenerating.[29]

Utilities may not, however, qualify for the benefits under this program if their ownership interests exceed the limits set forth in this rule.

Both the provisions in section 3(17)(C)(ii) and 3(18)(B)(ii) of the Federal Power Act, as amended by section 201 of PURPA, use the term person in describing who may own a qualifying cogeneration facility and qualifying small power production facility. The Commission has incorporated the ownership criteria under this section of the regulations and has used the term—person—found in the statute.

A few commenters questioned whether a municipality (or any other agency or instrumentality of State or Federal government) falls within the definition of the term "person" as used in definitions (17) and (18) in section 3 of the Federal Power Act. It is the Commission's view that the term "person," for purposes of qualifying under this program, does include municipalities (or any other agency or instrumentality of State or Federal government). This view is supported by case law in which the courts have treated municipalities and other units of State and Federal government as persons under other sections of the Federal Power Act. *See, e.g., United States v. Public Utilities Commission of California,* 345 U.S. 295 (1953); and *New England Power Co. v. FPC,* 349 F.2d 258 (1st Cir. 1965). The cases touching on the issue of these agencies as persons are very expansive (see the *California Public Utility Commission* decision cited above which was decided by the Supreme Court

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[29] Conference Report on H.R. 4018, Public Utility Regulatory Policies Act of 1978, H. Rep. No. 1750, 89-90, 95th Cong., 2d Sess. (1978).

in 1953). Therefore, under past practice, the Commission and the courts have not interpreted "person" to exclude a municipality or other unit of State and Federal government from the benefits of any action of the Federal Power Act.

In addition, in that there is no indication that the Congress meant to deny qualification to these agencies or instrumentalities, the Commission finds no policy grounds for denying these agencies or instrumentalities qualifying status. Therefore, both as a matter of law and as a matter of policy, the term "person" as used in section 3 (17)(C)(ii) and 3(18)(B)(ii) includes these agencies or instrumentalities. The effect of this is to allow these agencies or instrumentalities the opportunity to participate in this program if they otherwise meet the standards for qualification set out in this subpart.

§ 292.207 *Procedures for obtaining qualifying status.*

This section sets forth the procedures for obtaining qualifying status. Paragraph (a)(1) provides that a small power production facility which meets the criteria for qualification set forth in § 292.203 is a qualifying facility. As discussed above, the Commission has eliminated the mandatory case-by-case qualification procedure contained in the proposed rule.

Paragraph (a)(2) requires any owner or operator of a facility qualifying under paragraph (a)(1) to furnish notice to the Commission. The contents of the notice shall contain the information required of an applicant for qualifying status in paragraph (b)(2)(i) through (b)(2)(iv) described below. The Commission is requiring such notice for purposes of monitoring the market penetration of qualifying facilities, in compliance with its responsibilities under the National Environmental Policy Act of 1969, as previously discussed in this preamble.

Paragraph (b) provides an optional procedure whereby the owner or operator of a small power production facility or cogeneration facility may, should it prove desirable, file an application with this Commission for certification that the facility is a qualifying facility. The application must contain

enough information to enable the Commission to make an accurate finding that the facility should or should not be certified.

Specifically, paragraph (b)(i) through (v) provides that each application must contain the name and address of the applicant and the location of the facility, a brief description of the facility including a statement indicating whether such facility is a small power production facility or a cogeneration facility, the primary energy source used by the facility, the rated power production capacity of the facility, and the percentage of ownership by electric utilities, or public utility holding companies, or by any persons owned by either.

Applications by owners or operators of small power production facilities must also contain the location of the facility in relation to any other small power production facilities within one mile of the facility owned by the applicant which use the same energy resources, and information identifying any planned usage of natural gas, oil or coal.

An application by a cogenerator must contain the date installation of the facility commenced, a description of the cogeneration facility, including whether the facility is a topping or bottoming cycle, and sufficient information to determine that any applicable efficiency or operating requirements have been met.

Paragraph (b)(5) sets forth the procedures to be used by the Commission to determine whether a facility is to be granted qualifying status. It provides that, within 90 days of the filing of a complete application, the Commission shall issue an order granting or denying the application, extending the time for issuance of an order, or setting the matter for hearing. If no order is issued within 90 days of the filing of the application, it shall be deemed to have been granted.

The Commission will rely on its existing procedures for any person to file a petition for reconsideration of any Commission action instead of employing the protest procedure contained in the proposed rule.

Several commenters, while offering support for the elimination of filing and notice requirements for smaller facilities,

acknowledged the useful purpose that would be served by a requirement that a larger facility give notice to the affected utility of its qualifying status and its intention that such utility purchase its power. Accordingly, the Commission has provided a requirement in paragraph (c) that an electric utility is not required to purchase electric energy from a facility with a design capacity of 500 kilowatts or more until 90 days after the facility notifies the utility that it is a qualifying facility, or 90 days after the facility has applied to the Commission under paragraph (b).

Paragraph (d)(1) provides that the Commission may revoke the qualifying status of a facility if it ceases to comply with any of the statements contained in its application for Commission certification. The Commission may do so on its own motion, or upon a motion to reconsider any certification previously granted. In either case, the Commission will act only after providing an opportunity for a hearing. Paragraph (d)(2) provides that, prior to undertaking any substantial alteration of a qualifying facility, a small power production or cogenerator may, should it prove desirable, apply to the Commission for a determination that the facility, as modified, will retain its qualifying status.

IV. EFFECTIVE DATE

The Conference Report indicates that rules respecting criteria for qualifying facilities be prescribed "as soon as practicable" in order that persons may ascertain in advance of construction or operation of any facility whether or not such facility will meet the criteria established. The Commission believes, therefore, that good cause exists under 5 U.S.C. § 553(d) to make the rules promulgated in this order effective immediately.

These rules have been promulgated under the Federal Power Act, as amended by PURPA, and, therefore, a right to rehearing exists under section 313 of the Federal Power Act.

(Public Utility Regulatory Policies Act of 1978, 16 U.S.C. § 2601, *et seq.*, Energy Supply and Environmental Coor-

dination Act, 15 U.S.C. § 791 *et seq.*, Federal Power Act, as amended, 16 U.S.C. § 792 *et seq.*, Department of Energy Organization Act, 42 U.S.C. § 7101 *et seq.*, E.O. 12009, 42 F.R. 46267, Natural Gas Policy Act of 1978, 15 U.S.C. § 3301, *et seq.*)

In consideration of the foregoing, the Commission amends Part 292 of Chapter I, Title 18, Code of Federal Regulations, as set forth below, effective immediately.
By the Commission.

(SEAL)

KENNETH F. PLUMB,
Secretary.

1. Part 292 of Subchapter K is amended by adding a new Subpart B to read as follows:

SUBPART B — QUALIFYING COGENERATION AND SMALL POWER PRODUCTION FACILITIES

Sec.

292.201 Scope.
292.202 Definitions.
292.203 General requirements for qualification.
292.204 Criteria for qualifying small power production facilities.
292.205 Criteria for qualifying cogeneration facilities.
292.206 Ownership criteria.
292.207 Procedures for obtaining qualifying status.

(Authority: This part issued under the Public Utility Regulatory Policies Act of 1978, 16 U.S.C. § 2601, *et seq.*, Energy Supply and Environmental Coordination Act, 15 U.S.C. § 791 *et seq.*, Federal Power Act, as amended, 16 U.S.C. § 792 *et seq.*, Department of Energy Organization Act, 42 U.S.C. § 7101 *et seq.*, E.O. 12009, 42 F.R. 46267, Natural Gas Policy Act of 1978, 15 U.S.C. § 3301 *et seq.*)

SUBPART B — QUALIFYING COGENERATION AND SMALL POWER PRODUCTION FACILITIES

§ 292.201 *Scope.*

This subpart applies to the criteria for and manner of becoming a qualifying small power production facility and a qualifying cogeneration facility under sections 3(17)(C) and 3(18)(B), respectively, of the Federal Power Act, as amended by section 201 of the Public Utility Regulatory Policies Act of 1978 (PURPA).

§ 292.202 *Definitions.*

For purposes of this subpart:

(a) "biomass" means any organic material not derived from fossil fuels;

(b) "waste" means by-product materials other than biomass;

(c) "cogeneration facility" means equipment used to produce electric energy and forms of useful thermal energy (such as heat or steam), used for industrial, commercial, heating, or cooling purposes, through the sequential use of energy;

(d) "topping-cycle cogeneration facility" means a cogeneration facility in which the energy input to the facility is first used to produce useful power output, and the reject heat from power production is then used to provide useful thermal energy;

(e) "bottoming-cycle cogeneration facility" means a cogeneration facility in which the energy input to the system is first applied to a useful thermal energy process, and the reject heat emerging from the process is then used for power production;

(f) "supplementary firing" means an energy input to the cogeneration facility used only in the thermal process of a topping-cycle cogeneration facility, or only in the electric generating process of a bottoming-cycle cogeneration facility;

(g) "useful power output" of a cogeneration facility means the electric or mechanical energy made available for use,

exclusive of any such energy used in the power production process;

(h) "useful thermal energy output" of a topping-cycle cogeneration facility means the thermal energy made available for use in any industrial or commercial process, or used in any heating or cooling application;

(i) "total energy output" of a topping-cycle cogeneration facility is the sum of the useful power output and useful thermal energy output;

(j) "total energy input" means the total energy of all forms supplied from external sources other than supplementary firing, to the facility;

(k) "natural gas" means either natural gas unmixed, or any mixture of natural gas and artificial gas;

(l) "oil" means crude oil, residual fuel oil, natural gas liquids, or any refined petroleum products; and

(m) energy input in the case of energy in the form of natural gas or oil is to be measured by the lower hearing [sic] value of the natural gas or oil.

§ 292.203 *General requirements for qualification.*

(a) *Small power production facilities.* A small power production facility is a qualifying facility if it:

(1) meets the maximum size criteria specified in § 292.204(a);

(2) meets the fuel use criteria specified in § 292.204(b); and

(3) meets the ownership criteria specified in § 292.206.

(b) *Cogeneration facilities.* (1) Unless excluded under paragraph (c), a cogeneration facility is a qualifying facility if it:

(i) meets any applicable operating and efficiency standards specified in § 292.205(a) and (b); and

(ii) meets the ownership criteria specified in § 292.206.

(2) For purposes of qualification of a cogeneration facility for exemption from incremental pricing, a cogeneration facility must qualify under § 292.205(c).

(c) *Interim exclusion.* (1) Pending further Commission action, any cogeneration facility which is a new diesel cogeneration facility may not be a qualifying facility.

(2) A new diesel cogeneration facility is a cogeneration facility:

(i) which derives its useful power output from a diesel engine, and

(ii) the installation of which began on or after March 13, 1980.

§ 292.204 *Criteria for qualifying small power production facilities.*

(a) *Size of the facility.* (1) *Maximum size.* The power production capacity of the facility for which qualification is sought, together with the capacity of any other facilities which use the same energy resource, are owned by the same person, and are located at the same site, may not exceed 80 megawatts.

(2) *Method of calculation.* (i) For purposes of this paragraph, facilities are considered to be located at the same site as the facility for which qualification is sought if they are located within one mile of the facility for which qualification is sought and, for hydroelectric facilities, if they use water from the same impoundment for power generation.

(ii) For purposes of making the determination in clause (i), the distance between facilities shall be measured from the electrical generating equipment of a facility.

(3) *Waiver.* The Commission may modify the application of subparagraph (2) for good cause.

(b) *Fuel use.* (1)(i) The primary energy source of the facility must be biomass, waste, renewable resources, or any combination thereof, and more than 50 percent of the total energy input must be from these sources.

(ii) Any primary energy source which, on the basis of its energy content, is 50 percent or more biomass shall be considered biomass.

(2) Use of oil, natural gas, and coal by a facility may not, in the aggregate, exceed 25 percent of the total energy input of the facility during any calendar year period.

§ 292.205 *Criteria for qualifying cogeneration facilities.*

(a) *Operating and efficiency standards for topping-cycle facilities.*

(1) *Operating standard.* For any topping-cycle cogeneration facility, the useful thermal energy output of the facility must, during any calendar year period, be no less than 5 percent of the total energy output.

(2) *Efficiency standard.* (i) For any topping-cycle cogeneration facility for which any of the energy input is natural gas or oil, and the installation of which began on or after March 13, 1980, the useful power output of the facility plus one-half the useful thermal energy output, during any calendar year period, must:

(A) subject to subclause (B), be no less than 42.5 percent of the total energy input of natural gas and oil to the facility; or

(B) if the useful thermal energy output is less than 15 percent of the total energy output of the facility, be no less than 45 percent of the total energy input of natural gas and oil to the facility.

(ii) For any topping-cycle cogeneration facility not subject to clause (i), there is no efficiency standard.

(b) *Efficiency standards for bottoming-cycle facilities.*

(1) For any bottoming-cycle cogeneration facility for which any of the energy input as supplementary firing is natural gas or oil, and the installation of which began on or after March 13, 1980, the useful power output of the facility must, during any calendar year period, be no less than 45 percent of the energy input of natural gas and oil for supplementary firing.

(2) For any bottoming-cycle cogeneration facility not covered by subparagraph (1), there is no efficiency standard.

(c) *Exemption from incremental pricing.* (1) Natural gas used in any topping-cycle cogeneration facility is eligible for an exemption from incremental pricing under Title II of the Natural Gas Policy Act of 1978 (NGPA) and Part 282 of the Commission's rules if:

(i) the facility meets the operating and efficiency standards under paragraphs (a)(1) and (2)(i) of this section and is a qualifying facility under § 292.203(b)(1); or

(ii) the facility is a qualifying facility under Subpart E of this part.

(2) Natural gas used in any bottoming-cycle cogeneration facility, not subject to an exemption from incremental pricing under Subpart E of this part, is eligible for an exemption under Title II of the NGPA and Part 282 of the Commission's rules to the extent that reject heat emerging from the useful thermal energy process is made available for use for power production.

(3) Nothing in this subpart affects any exemption provided under Subpart E of this part.

(4) Natural gas used for supplementary firing in any cogeneration facility is not eligible under this part for exemption from incremental pricing.

(d) *Waiver.* The Commission may waive any of the requirements of paragraphs (a), (b) and (c) upon a showing that the facility will produce significant energy savings.

§ 292.206 *Ownership criteria.*

(a) *General rule.* A cogeneration facility or small power production facility may not be owned by a person primarily engaged in the generation or sale of electric power (other than electric power solely from cogeneration facilities or small power production facilities).

(b) *Ownership test.* For purposes of this section, a cogeneration or small production facility shall be considered to be owned by a person primarily engaged in the generation or sale of electric power, if more than 50 percent of the equity interest in the facility is held by an electric utility or utilities, or by a public utility holding company, or companies, or any combination thereof. If a wholly or partially owned subsidiary of an electric utility or public utility holding company has an ownership interest of a facility, the subsidiary's ownership interest shall be considered as ownership by an electric utility or public utility holding company.

§ 292.207 *Procedures for obtaining qualifying status.*

(a) *Qualification.* (1) A small power production facility or cogeneration facility which meets the criteria for qualification set forth in § 292.203 is a qualifying facility.

(2) The owner or operator of any facility qualifying under this paragraph shall furnish notice to the Commission providing the information set forth in paragraph (b)(2)(i) through (iv).

(b) *Optional procedure.* (1) *Application for Commission certification.* Pursuant to the provisions of this paragraph, the owner or operator of the facility may file with this Commission an application for Commission certification that the facility is a qualifying facility.

(2) *General contents of application.* The application shall contain the following information:

(i) the name and address of the applicant and location of the facility;

(ii) a brief description of the facility, including a statement indicating whether such facility is a small power production facility or a cogeneration facility;

(iii) the primary energy source used or to be used by the facility;

(iv) the power production capacity of the facility; and

(v) the percentage of ownership by any electric utility or by any public utility holding company, or by any person owned by either.

(3) *Additional application requirements for small power production facilities.* An application by a small power producer for Commission certification shall contain the following additional information:

(i) the location of the facility in relation to any other small power production facilities located within one mile of the facility, owned by the applicant which use the same energy source; and

(ii) information identifying any planned usage of natural gas, oil or coal.

(4) *Additional application requirements for cogeneration facilities.* An application by a cogenerator for Commission certification shall contain the following additional information:

(i) a description of the cogeneration system, including whether the facility is a topping or bottoming cycle and sufficient information to determine that any applicable requirements under § 292.205 will be met; and

(ii) the date installation of the facility began or will begin.

(5) *Commission action.* Within 90 days of the filing of an application, the Commission shall issue an order granting or denying the application, tolling the time for issuance of an order, or setting the matter for hearing. Any order denying certification shall identify the specific requirements which were not met. If no order is issued within 90 days of the filing of the complete application, it shall be deemed to have been granted.

(c) *Notice requirements for facilities of 500 kw or more.* An electric utility is not required to purchase electric energy from a facility within a design capacity of 500 kw or more until 90 days after the facility notifies the utility that it is a qualifying facility, or 90 days after the facility has applied to the Commission under paragraph (b).

(d) *Revocation of qualifying status.* (1) The Commission may revoke the qualifying status of a qualifying facility which has been certified under this section if such facility fails to comply with any of the statements contained in its application for Commission certification.

(2) Prior to undertaking any substantial alteration or modification of a qualifying facility which has been certified under this section, a small power producer or cogenerator may apply to the Commission for a determination that the proposed alteration or modification will not result in a revocation of qualifying status.

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

[18 CFR Part 292]

(Docket Nos. RM79-54 and RM79-55)

ORDER GRANTING IN PART AND DENYING IN PART REHEARING OF ORDER NOS. 69 AND 70, AND AMENDING REGULATIONS

(Issued May 15, 1980)

AGENCY: Federal Energy Regulatory Commission.

ACTION: Order Granting in Part and Denying in Part Rehearing of Order Nos. 69 and 70, and Amending Regulations.

SUMMARY: The Federal Energy Regulatory Commission (Commission) hereby adopts an order granting in part and denying in part petitions for amendment of Order Nos. 69 and 70. The Order amends four sections of the Commission's rules involving small power production. The amendments involve the definition of "total energy input," general requirements for qualification of new dual-fuel cogeneration facilities, fuel use criteria for qualifying small power production facilities, and the exemption of qualifying facilities from sections 19 and 20 of the Federal Power Act.

EFFECTIVE DATE: May 15, 1980.

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UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Docket Nos. RM79-54 and RM79-55

Before Commissioners:

Charles B. Curtis, *Chairman;*
Georgiana Sheldon, Matthew Holden, Jr.
and George R. Hall.

SMALL POWER PRODUCTION AND COGENERATION FACILITIES — RATES AND EXEMPTIONS, QUALIFYING STATUS

ORDER GRANTING IN PART AND DENYING IN PART REHEARING OF ORDER NOS. 69 AND 70, AND AMENDING REGULATIONS

(Issued May 15, 1980)

On February 19, 1980, the Federal Energy Regulatory Commission (Commission) issued Order No. 69, the "Final Rule Regarding the Implementation of Section 210 of the Public Utility Regulatory Policies Act of 1978" (PURPA) in Docket No. RM79-55.[1] The Commission received six applications for rehearing or reconsideration.[2]

1 45 *Fed. Reg.* 12214 (February 25, 1980).

2 Southern Company Services, Inc. (March 14, 1980), Essex Development Association (March 14, 1980), American Electric Power Service

On March 13, 1980 the Commission issued, in Docket No. RM79-54, Order No. 70, the "Final Rule Establishing Requirements and Procedures for a Determination of Qualifying Status for Small Power Production and Cogeneration Facilities."[3] That rule established criteria and procedures whereby

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Corporation (March 14, 1980), Edison Electric Institute (March 20, 1980), Consolidated Edison Company and Boston Edison Company (March 20, 1980), and Colorado-Ute Electric Association, Inc. (April 11, 1980).

The Commission notes that, while there is no express statutory right to rehearing of rules issued under section 210 of PURPA, there is a statutory right to rehearing of rules issued under section 201 of PURPA, which amended the Federal Power Act (FPA) by adding sections 3(17)-3(22). The Commission's view is that Congress, in incorporating by reference the enforcement provision of the Federal Power Act (Section 210h of PURPA), intended also to incorporate by reference the rehearing and judicial review provision of the Federal Power Act.

In addition, a case involving the Natural Gas Act and the Natural Gas Policy Act of 1978, the Court observed that

> . . . it is often not possible to draw a precise line separating the boundaries of the two Acts. Implementation of many NGPA provisions requires conduct by FERC authorized under both Acts. As a result, the promulgation of rules may entail the exercise of authority under both the NGA and the NGPA. *Ecee, Inc.* v. *Federal Energy Regulatory Commission*, 611 F.2d 554, 564-566 (5th Cir. 1980).

The Commission notes that section 210 of PURPA and sections 3(17)-3(22) of the FPA, as added by section 201 of PURPA, are, to a large extent, interrelated. Section 201 of PURPA establishes the criteria and procedures by which a cogeneration or small power production facility can become a "qualifying" facility; section 210 of PURPA establishes rates for sales and purchases of electric power between qualifying facilities and electric utilities, and exempts qualifying facilities from certain State and Federal regulation. The relationship between the FPA and PURPA in this proceeding is thus similar to that between the NGA and the NGPA. For the reasons set forth in *Ecee*, the issues will be more clearly delinated, and the task of separating interrelated sections will be obviated, if these rulemakings are subject to review in the same forum. The Commission expects that any review of its order on rehearing in Docket Nos. RM79-54 and RM79-55, would occur in the Courts of Appeal, pursuant to section 313(b) of the FPA.

3 45 *Fed. Reg.* 17959 (March 20, 1980).

small power production and cogeneration facilities could determine if they were eligible to receive the rate benefits and exemptions set forth in the Commission's rules implementing section 210 of PURPA.

The Commission received four petitions for rehearing of Docket No. RM79-54.[4]

With the exception of arguments discussed below, these applications raised no new matters of fact or law.

ORDER NO. 69

Interconnection § 292.303(c)

Consolidated Edison Company (Con Ed), Boston Edison Company, and Edison Electric Institute (EEI) recommended that the Commission determine that the interconnection procedures set forth in sections 210 and 212 of the Federal Power Act (FPA) are applicable to qualifying facilities, rather than requiring electric utilities to interconnect with a qualifying facility as an act included within the obligation to purchase, and not requiring an evidentiary hearing and the rendering of certain findings required under sections 210 and 212 of the FPA. In the final rule, the Commission observed that section 212(e) of the FPA provides that no provision of section 210 of the FPA should be treated as an exclusive means of obtaining relief.[5] The Commission interpreted this provision to mean that the existence of any authority under section 210 of the FPA to require interconnection should not be interpreted as exclusive of any other interconnection authority available under any other law. The Commission interpreted section 210(a) of PURPA as providing a broad grant of authority to prescribe

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4 Southern Company Services, Inc. (April 11, 1980), Consolidated Edison Company (April 14, 1980), Southern California Gas Company (April 14, 1980), Elizabethtown Gas Company (April 14, 1980).

5 Section 212(e) of the FPA states that no provision of section 210 of the FPA shall be treated "(1) as requiring any person to utilize the authority of such section 210 or 211 in lieu of any authority of law, or (2) as limiting, impairing, or otherwise affecting any other authority of the Commission under any other provision of law."

rules necessary to encourage cogeneration and small power production, including the authority to require interconnection.

In their application, Con Ed and Boston Edison argued that the fact that Congress prohibited the Commission from exempting any qualifying facility from the provisions of sections 210 or 212 of the FPA renders moot or irrelevant the express ability of the Commission to resort to other authority to require interconnections. They state that while section 210(a) of PURPA provides the FERC with a broad mandate to prescribe rules as it determines necessary, the Congress, in section 210(e) specifically prohibited the Commission from exempting any qualifying facility from the provisions of sections 210 or 212 of the FPA. As a result, Con Ed and Boston Edison claim that to read section 210(a) of PURPA as granting the "very authority specifically denied in section 210(e) of PURPA is to render the latter subsection utter surplusage."

The primary question arising from these claims is the proper interpretation of section 210(e)(3)(B) of PURPA, which provides that qualifying facilities cannot be exempted from sections 210, 211, and 212 of the FPA.

Section 210 of the FPA grants to electric utilities, Federal power marketing agencies, and qualifying cogenerators and small power producers the right to apply for a Commission order requiring interconnection. The "target" of such an interconnection order can be "any cogeneration facility, any small power production facility, or the transmission facilities of any electric utility."[6]

Thus, in the procedures set forth in sections 210 and 212 of the FPA, qualifying facilities may either be applicants for interconnection orders, or targets of such interconnection orders. These sections confer upon qualifying facilities the right to apply for interconnection orders; they also impose on qualifying facilities the obligation and liability to be subjected to interconnection orders.

Section 210(e) of PURPA sets forth categories of State and Federal laws from which qualifying facilities can be exempted.

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6 Section 210(a)(1)(A), Federal Power Act.

The intent of this exemption is to remove the burden associated with being subjected to regulations as an electric utility under the FPA, the Public Utility Holding Company Act, and State laws regulating rates and financial organizations of electric utilities. The Joint Explanatory Statement of the Committee of Conference (Conference Report) accompanying PURPA states that rate regulation of qualifying facilities is to be done in a "less burdensome manner than traditional utility-rate regulation."[7] It further notes that

> [t]he establishment of utility type regulation over (cogeneration and small power production facilities) would act as a significant disincentive to firms interested in cogeneration and small power production.[8]

Thus, by exempting qualifying facilities from this type of regulation, Congress relieved them from liabilities and requirements to which others (*viz.*, non-qualifying facilities) are subject. Use of the word "exempt" in this context is consistent with its definition: "to release or deliver from some liability or requirement to which others are subject."[9] To "exempt" qualifying facilities does not mean to deny them a privelege [sic] or right to which they would otherwise be entitled; to exempt means to relieve of undesirable responsibility or obligation.

Sections 210 and 212 provide that, if the Commission makes certain determinations, it can impose obligations on qualifying facilities, including requiring the physical connection of the qualifying facility with the applicant, the sale or exchange or [sic] electric energy, or an increase in transmission capacity necessary to carry out these provisions. The Commission believes it is from these obligations that section 210(e)(3)(B) provides that qualifying facilities may not be exempted. Unlike the interpretation proffered by Con Ed and Boston Edison this

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7 Conference Report in H.R. 4018, Public Utility Regulatory Policies Act of 1978, H.R. Rep. No. 1750, 95th Cong., 2d Sess. 97 (1978).

8 *Id.*

9 Webster's Third New International Dictionary (1976).

reading comports with the plain meaning of the statute and with the accepted use of the language. And because qualifying facilities remain liable to being a target to an order under sections 210 and 212 of the FPA, section 210(e)(3)(B) is not "render[ed] utter surplusage."[10]

Under Con Ed's and Boston Edison's reading, section 210(e)(3)(B) of PURPA would also mean that qualifying facilities may not be exempted from applying under section 210 of the FPA to the Commission for an order requiring interconnection. The Commission notes that the ability to *apply* for an interconnection order is not a duty, liability, or requirement to which a qualifying facility is subject; it is a grant of standing to request the Commission to impose an obligation on another party (viz., a target of an interconnection order).[11]

Under Con Ed's reading, the Commission may not "exempt" a qualifying facility from this statutory privilege. Since, as noted previously, to exempt means to relieve of liabilities, and not be excluded from rights or privileges, this interpretation does not seem consonant with the plain meaning of the statutory language.

Transmission § 292.303(d)

Southern Company Services, Inc. (Southern Company), stated that § 292.303(d) appears to prohibit an electric utility transmitting from a qualifying facility to another electric utility from levying a transmission charge. This interpretation is not the one intended by the Commission. The sentence in question states that "[t]he rate for purchase by the electric utility to which such energy is transmitted . . . shall not include any charges for transmission." This phrase is intended to limit the amount that the utility to which electric energy is ultimately

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10 Petition for Rehearing and Reconsideration, Con Ed and Boston Edison, *supra* note 1, *mimeo* at 6.

11 Indeed, the ability to apply for an order imposing an obligation to wheel or transmit power was not conferred upon qualifying facilities; thus exclusion from being an applicant is an important distinction between sections 210 and 211 of the FPA.

delivered must pay. This sentence provides that the purchasing utility need purchase this energy at a rate which reflects the costs it can avoid as a result of making such a purchase, and that any costs incurred to deliver the energy to it are the responsibility of the selling qualifying facility. (The transmitting utility may, however, agree to bear some or all of the transmission costs.)

The Commission does intend that an electric utility which *transmits* energy from a qualifying facility to another electric utility be permitted to receive reimbursement for this transmission service. As noted by Southern Company Services, this intent is expressed in the preamble, where the Commission stated:

> In the case of electric utilities not subject to the jurisdiction of this Commission, these (transmission) charges should be determined under applicable State law or regulation which may permit agreement between the qualifying facility and any electric utility which transmits energy or capacity with the consent of the qualifying facility. For utilities subject to the Commission's jurisdiction under Part II of the Federal Power Act, these charges will be determined pursuant to Part II.[12]

Southern Company recommends that these provisions be added to section 292.303(d), in place of the sentence which provides that rates for purchases shall not include any charges for transmission. The Commission believes that the provision as issued is acceptable. With this clarification, the proper interpretation should be clear.

Exemptions § 292.601(b)

On March 19, 1980, Essex Development Associates (Essex) filed a Motion for Clarification of Order No. 69. Essex observed that the Commission did not exempt qualifying facilities from sections 19 and 20 of the Federal Power Act

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12 Order No. 70, *supra, mimeo* at 32.

(FPA or Act). Essex stated that these sections provide the Commission with discretionary jurisdiction to regulate rates and the issuance of securities by licencees under Part I of the Federal Power Act. Essex contends that the intent of section 210 of PURPA and of Order No. 69, is to eliminate utility-type regulation of cogenerators and small power producers, without regard to the status of the facility as a licensee under Part I of the Federal Power Act. Essex requests that the Commission amend Order No. 69 to exempt qualifying facilities from sections 19 and 20 of the FPA, or that the Commission waive its rights under sections 19 and 20 to regulate a qualifying small power producer.

It should be noted that section 210(e)(3)(C) of PURPA provides that no qualifying facility may be exempted from

> . . . any license or permit requirement under Part I of the Federal Power Act, any provision under such Act related to such a license or permit requirement, or the necessary authorities for enforcement of any such requirement.

The threshhold [sic] question is whether this section should be interpreted to prevent the exemption of qualifying facilities from sections 19 and 20 of the Federal Power Act.

The intent of section 210(e) of PURPA, and of § 292.601 of the Commission's regulations (exemption to qualifying facilities from the Federal Power Act), is to remove the disincentive associated with utility-type regulation.[13] In Order No. 69, the Commission exempted qualifying facilities from cost-of-service regulation of rates, and from regulation of securities to which jurisdictional public utilities are subject under Part II of the Federal Power Act. In addition, within the statutory parameters, the Commission exempted qualifying facilities from regulation as electric utilities under the Public Utility Holding Company Act, and from State regulation of rates and financial organization.

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13 Conference Report in H. R. 4018, Public Utility Regulatory Policies Act of 1978, H. R. Rep. No. 1750, 95th Cong., 2nd Sess. 98 (1978).

Regulation under Part II of the Federal Power Act chiefly involves regulation of rates and financial organization, while regulation under Part I of the Act concerns the licensing of hydroelectric projects. A licensed project under Part I of the Federal Power Act may also be a qualifying small power producer, if it meets the size and ownership requirements set forth in Order No. 70.[14]

In pertinent part, section 19 of the Federal Power Act provides that, as a condition of a license, a licensee "developing, transmitting, or distributing power for sale or use in public service," shall abide by the rate and service regulation of any duly constituted agency of the State in which such service is provided. If power is provided in a State in which there is no authorized regulatory commission to regulate the rates for sales of power, or the issuance of securities by a licensee, jurisdiction is conferred on the Commission to regulate these matters.

Section 20 of the FPA provides that, with regard to power from a licensed project that enters interstate or foreign commerce, the rate charged shall be "reasonable, nondiscriminatory, and just to the customer," and all "unreasonable discriminatory and unjust rates" are prohibited. It provides that if any State affected has not established a commission to enforce these requirements, or to regulate the issuance of securities, or if any parties or States are unable to agree on appropriate regulation, jurisdiction is conferred on the Commission to regulate these activities.

The Commission observes that most of the provisions of Part I of the Act impose conditions and restrictions on the

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14 Section 292.206 of the Commission's rules provides that a facility cannot qualify if more than 50 percent of the equity interest in the facility is held by an electric utility or utilities, or public utility holding companies. Section 292.204(a) provides that the power production capacity of a qualifying facility may not exceed 80 megawatts. Pursuant to § 292.601 (Order No. 69), only small power production facilities of 30 mw or less are exempted from the Federal Power Act, the Public Utility Holding Company Act, and State regulation, except biomass facilities between 30 and 80 megawatts, which are exempt from State regulation and from the Public Utility Holding Company Act.

construction and operation of hydroelectric facilities, which require that licensed projects comply with comprehensive development of the nation's waterways. As a result, the Commission perceives no inconsistency in exempting licensed projects that are qualifying facilities from State and Federal regulation of rates and financial organization, and maintaining Federal regulation of the physical structure of such facilities, and their manner of operation. The Commission believes that the limitation on exemption from the Federal Power Act set forth in section 210(e)(3)(C) of PURPA was intended to ensure that licensees comply with the requirements concerning comprehensive development of waterways, and ensure that they do not build or operate hydroelectric projects in a manner inconsistent with the public interest.

Nowhere in the legislative history of section 210, or in the Conference Report, does there appear any indication that qualifying facilities that are licensed hydroelectric projects were intended to be singled out for utility-type rate or securities regulation. To subject these licensed projects to such regulation would be inconsistent with the intent of this section of PURPA—to encourage cogeneration and small power production. Thus, the Commission finds no basis to subject small power producer licensees to regulation under sections 19 and 20 of the Act, when they would otherwise be exempted from utility-type regulation at both the Federal and State levels.[15]

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[15] The Commission observes that even if exemption from these provisions were not granted, the residual grant of authority to the Commission set forth in sections 19 and 20 is consistent with the rate and exemption provisions of section 210 of PURPA, and with Order No. 69. Section 210(b) provides that rates for purchases from qualifying facilities shall be "just and reasonable to the electric consumers of the electric utility and in the public interest, and shall not discriminate against qualifying facilities." Section 292.304(a) repeats these statutory requirements. Section 210(f) of PURPA and § 292.401 of the Commission's rules require that, within one year after the Commission's rules take effect, each State regulatory authority is to implement the rules issued by the Commission regarding rates for purchases and sales of electric energy and capacity between qualifying facilities and electric utilities. After State implementation takes place, compliance with section 19—whether viewed as State regulation in the first instance or residual Federal regulation—would be accomplished through the State's program implementing section 210 of PURPA, and Order No.

Moreover, the Commission finds no basis to believe that section 210 of PURPA was intended to grant exemptions from the regulations of rates and financial organization, and yet to retain the authority to impose regulation of rates and the issuance of securities for one class of small power producers.

Rules of statutory construction indicate that the Commission should look to the object to be accomplished, and the evils sought to be remedied.[16] Moreover, a statute should be construed so as to effect its purpose.[17] The Commission has cited the reference in the Conference Report regarding its disincentives associated with "utility type regulation." It further cites the Conference Report statement that

> [I]t is not the intention of the conferees that cogeneration and small power producers become subject . . . to the type of examination that is traditionally given to electric utility rate applications to determine what is the just and reasonable rate that they should receive for their electric power.[18]

The authority contained in sections 19 and 20 of the Federal Power Act would reserve to the Commission the authority to impose this type of utility regulation on qualifying small power producer licensees. The possibility that such regulation will be imposed could reduce the encouragement of development of small power production which the Congress, in section 210 of PURPA, and the Commission, in Order No. 69, intended to

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69. Similarly, the requirements set forth in section 20 regarding the rates for power from licensed projects are not inconsistent with the requirements of section 210 of PURPA, or Order No. 69. Again, regulation under section 210 of PURPA would constitute the vehicle for regulation under section 20 of the Act. (For qualifying small power production facilities greater than 30 mw, where the facility is subject to Commission jurisdiction under Part II of the Federal Power Act, the Commission will establish rates for purchase in accordance with the avoided cost principles set forth in § 292.304).

16 82 C. J. S. *Statutes* § 323.

17 *Id.*

18 Conference Report, *supra* note 13, at 97.

provide. For the reasons set forth, the Commission finds it appropriate to exempt qualifying facilities from these sections of the Federal Power Act.

Accordingly, the Commission amends § 292.601(b)(1), so as to exempt qualifying facilities from sections 19 and 20 of the Federal Power Act.

ORDER NO. 70

Definitions § 292.202

Sections 292.202(i) and 292.202(j), define the "total energy output" and "total energy input" of a qualifying facility. Dividing the total energy output by the total energy input indicates the efficiency of the facility.

In § 292.202(j) of the final rule, energy obtained from supplementary firing was inadvertently excluded from the definition of total energy input. Since energy from supplementary firing was not excluded from the definition of total energy *output,* the rule would distort the efficiency of facilities in which large amounts of energy are supplied from supplementary firing, making them appear more efficient than they are.

To correct this unintended result, the Commission is amending the definition of total energy input so that it includes energy supplied from supplementary firing. This change will be accomplished by deleting the clause "other than supplementary firing" from the definition of total energy input.

Ownership § 292.206(b)

Southern California Gas Company (SCGC) and Elizabethtown Gas Company (Elizabethtown) contend that § 292.206(b) of the Commission's rules erroneously exclude from qualifying status facilities owned by public utility holding companies that are not engaged in the generation or sale of electricity other than from cogeneration facilities or small power production facilities. Elizabethtown states that the rules do not prohibit a gas distribution utility from owning a qualifying facility.

Sections 17(C)(ii) and 18(B)(ii) of the Federal Power Act require the Commission to limit qualifying status to facilities "owned by persons not primarily engaged in the generation or sale of electric power." Section 292.206 of the Commission's rules prohibits public utility holding companies from owning more than 50 percent of the equity interest of a qualifying facility.

The Commission did not intend to prohibit companies without any electric utility interests from owning qualifying facilities. However, because public utility holding companies are subject to many special restrictions, before changing this provision of its rules, the Commission believes it appropriate to consult with the Securities and Exchange Commission to determine whether permitting gas holding companies to own qualifying facilities is consistent with that agency's regulation of holding companies.

Fuel Use § 292.204(b)(1)

Southern Company takes exception to the fuel use criteria employed by the Commission in defining a qualifying small power production facility under § 292.204(b) of the rules. In the proposed rule, the term "primary energy source" was not defined. In response to several comments that standards should be established for determining the primary energy source, the Commission required in § 292.204(b)(1) of the final rule that more than 50 percent of the total energy input of a qualifying facility be from biomass, waste, renewable resources, or any combination thereof.

Southern Company states that a small power production facility which utilizes biomass, waste, or renewable resources as its "primary energy source" no more than 51 percent of the time, complies with the "sole" use requirement of the PURPA definition. Southern Company contends that this standard should be eliminated in favor of a standard which requires a small power production facility to use a higher percentage of renewable resources, waste, or biomass.

Two provisions of the rules are involved in this issue. Section 292.204(b)(2) provides that the oil, natural gas, and coal used

by a qualifying facility may not, in the aggregate, exceed 25 percent of the total energy input of the facility during any calendar year. As discussed in the preamble[19], comments received indicated that effective use of biomass or waste as fuels can require that as much as 25 percent of the heat input be from fossil fuel. To assure that these renewable resources qualify for the statutory benefits, the Commission adopted the "25 percent rule."

As noted above, § 292.204(b)(1)(i) provides that more than 50 percent of the total energy input to a qualifying small power production facility must be biomass, waste, renewable resources, or any combination thereof.

At this time, the Commission believes that there are virtually no eligible fuels which are feasible for use by a qualifying facility to fill the hiatus if it derives 50 percent of its energy input from biomass, waste or renewable resources, and 25 percent from oil, natural gas and coal. The Commission will accordingly amend this provision of its rule to require that at least 75 percent of the total energy input of a qualifying small power production facility be from biomass, waste, renewable resources, or any combination thereof.

§ 292.204(b)(2).

Southern Company also contends that the Commission's 25 percent limit on fossil fuel use by qualifying facilities is too broad, and is inconsistent with national energy policy. Southern Company argues that the Commission should adopt individual standards for each category of fossil fuel use listed in section 201 of PURPA, as appeared in the notice of proposed rulemaking.[20]

The Commission rejects this petition. The Commission based the 25 percent standard on the comments filed which

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19 Order No. 70, *supra,* mimeo at 38-40.

20 These categories include fuel used for ignition, startup, testing, flame stabilization, and control uses, and fuel used to alleviate or present unanticipated equipment outages and emergencies that would affect public health, safety or welfare. Section 3(17)(B), FPA.

generally favored a uniform aggregate standard. Commenters argued that separate standards for startups, flame stablization [sic] and outages are unnecessarily burdensome. They also claimed that some small power production technologies would be severely constrained by one of the standards while requiring little or no fossil fuel for other purposes. Additionally, the Commission believes that to the extent oil and natural gas remain more expensive than other energy sources available to small power producers, there is an economic disincentive to use more fossil fuel than is absolutely necessary.

Southern Company stated that the Commission's rules are inconsistent with standards promulgated under the Powerplant and Industrial Fuel Use Act of 1978 (FUA). The Commission notes that the FUA is intended to encourage the burning of coal in conventional power plants and industrial fuel burning plants. In contrast, sections 201 and 210 of PURPA are intended to encourage the cogeneration and electric generation through the use of biomass, waste, and renewable resources. Coal may not be used by a qualifying small power production facility as a primary energy source. Southern Company argues that the Commission should adopt, in its rules, the definition of "primary energy source" set forth in the interim rules implementing the FUA. These rules provide that a facility's consumption of oil and gas may not exceed five percent of the facility's annual Btu output. While the use of five percent gas or oil may be sufficient in combination with coal fuel, the burning of biomass or waste can require a greater use of gas of oil. Comments indicate that if the Commission were to adopt the more stringent five percent standard, the operation of many of these energy sources would not be feasible. Consequently, the Commission does not find that its rules are inconsistent with FUA standards, and rejects this proposed revision of the rules.

§ § 292.203(b) and 292.205

Southern Company and Con Ed submit that the Commission's rules are inconsistent with national energy policy in that

they allow cogeneration facilities to burn oil and natural gas. Both petitioners request that the Commission amend its rules to include fuel use criteria for cogeneration facilities which the Commission determines to be qualifying cogeneration facilities. The result, they contend, of the Commission's failure to include fuel use restrictions is to authorize the burning of oil or natural gas for generation of electricity in cogeneration units, which will displace electricity generated by coal, nuclear or hydro power.

Numerous comments on this issue were submitted during the rulemaking process. First, the Commission notes that these rules do not authorize any facility to burn oil or gas in contravention of any applicable Federal, State or local laws or regulations. Rather, their effect is to make facilities, some of which may be authorized to burn fossil fuels under other statutory authority, such as the FUA, eligible for the rate and exemption privileges set forth in section 210 of PURPA.

As noted in the preamble[21] the Commission believes that the legislative history, Congressional intent, and national energy policy support the use of oil and gas in cogeneration facilities. Section 206(c)(3) of the Natural Gas Policy Act, authorized the Commission to exempt gas used by qualifying cogeneration facilities from incremental pricing surcharges.

Furthermore, the Commission believes that economics will make the displacement of nuclear coal or hydro generated electricity by a cogenerator using oil or natural gas a rare occurrence. In most cases, electricity generated by a cogenerator using oil or gas fuels is more expensive than electrcity generated by nuclear, coal or hydro facilities. As a result, market forces, rather than an additional layer of Federal fuel use regulation, can effectively determine the appropriate use of oil or gas. For the above reasons the Commission denies the petition for amendment of this section of the rule.

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21 Order No. 70, *supra, mimeo* at 24-26.

Notice § 292.207

Southern Company and Con Ed petitioned the Commission to amend § 292.207 of its rules. This provision requires all qualifying facilities to furnish notice to the Commission of their status as qualifying facilities, and to provide a brief description of the facility and other pertinent data. The petitioners requested that the Commission require an applicant for certification of qualifying status intending to interconnect with a utility to furnish notice to the appropriate State regulatory authority and the utility with which it would interconnect.

The Commission has recently amended § 292.207(b)(6) of its rules.[22] This amendment requires that all applications for Commission certification of qualifying status include a notice of such request for publication in the *Federal Register.* The Commission believes that publication will provide adequate notice of applications for qualifying status. The Commission, therefore, rejects the petitions for amendment of § 292.207 of its rules.

Southern Company also petitioned the Commission to amend § 292.207(c) of the rule. This paragraph states that an electric utility is not required to purchase electric energy from a qualifying facility of 500 kilowatts or more until 90 days after the facility notifies the utility that it qualifies, or that it has applied to the Commission for qualification. Southern Company contended that this section implies that a utility is derelict if it does not begin purchasing power from a qualifying facility over 500 kilowatts within 90 days after the facility has notified the utility or applied to the Commission for certification as a qualifying facility. Southern Company believes that 90 days is not a sufficient time period in which it can adjust its system to receive the generation output of the qualifying facility. Southern Company requested amending § 292.207(c) to allow for a "reasonable time" in which it must begin purchasing power from a qualifying facility.

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22 Amendment to Final Rule Providing That Applications For Commission Certification of Qualifying Status Contain a Notice for Publication in the Federal Register, Order No. 70-A, Docket No. RM79-54, May 5, 1980.

Southern Company has erroneously interpreted § 292.207(c). Section 292.207(c) must be read in conjunction with § 292.207(b)7 and § 292.306. These sections provide that a utility is required to purchase power from a qualifying facility only if the facility meets all safety requirements, and pays for the appropriate interconnection costs as determined by the State regulatory authority. The 90-day requirement set out in § 292.207(c) establishes a minimum time period in which a utility must purchase power from a qualifying facility which has met all other applicable safety and interconnection requirements of the regulations. A utility need not purchase power from a qualifying facility until it meets these requirements, even if the 90-day period has elapsed. The Commission believes this interpretation of the regulation allows for a reasonable time period in which a utility must purchase power from a qualifying facility. Therefore, the Commission rejects the petition for amendment of this section.

Procedures for Obtaining Qualifying Status § 292.207

Con Ed states that the self-certifying procedure for obtaining qualifying status fails to inform utilities whether a particular facility is qualified. Under the proposed rule, all determinations of qualifications would have required Commission action on a case-by-case basis. Comments received indicated that when no affected party questions the eligibility of a facility, there is no need to require filing for qualification. As noted in the preamble to Order No. 70, the initiation of negotations concerning purchase and sale arrangements allows for the flow of information between potential qualifying facilities and affected electric utilities.[23] If a utility consides that a facility does not qualify, it is not obligated to purchase its electric output. In such cases, the facility may seek Commission certification under § 292.207(b). The Commission expects that, for the great majority of facilities requesting that utilities purchase their electric output, there will be no disagreement as to their

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23 Order No. 70, *supra*, *mimeo* at 19.

eligibility. In questionable cases, the rules as issued provide for Commission determination of the facility's status. Thus, the Commission perceives no need to require additional paperwork in uncontested determinations.

§ 292.206(d)

Con Ed requested that the Commission amend § 292.206(d) to include a mechanism for monitoring facilities to assure that the requirements for obtaining qualifying status continue to be met.

The Commission believes that the administrative costs associated with monitoring large numbers of qualifying facilities would be prohibitive. The Commission notes that section 201 of PURPA amended the Federal Power Act, and that these rules fall under the ambit of the enforcement provisions of sections 314 and 316 of the FPA. Under these provisions, an applicant that ceases to meet the requirements for qualifying status, and fails to notify the Commission pursuant to § 292.207(d)(2) may be subject to civil and criminal penalties. The Commission will investigate any complaints that qualifying requirements are not being met. As a result, the Commission believes it is not necessary to establish a monitoring system.

Evironmental Effects § 292.203(c)

In the Environmental Assessment (EA) issued with Docket No. RM79-54[24], the Commission determined that the incentives provided in this program will encourage the development of only one technology, commercial cogeneration primarily by new diesel engines, at a level where significant environmental effects may occur in the near-term. Con Ed contended that spark ignition and dual-fuel cogeneration engines will also be widely used in commercial applications and will produce a substantial environmental impact.

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[24] Notice of No Significant Impact and Notice of Intent to Prepare Environmental Impact Statement, issued March 31, 1980, Docket No. RM79—54, *mimeo* at 44.

Con Ed's petition does not refer to the discussion contained in the Appendices to the EA, referred to in the Commission's Notice accompanying the EA. In Appendix C the Commission stated:

> Dual-fuel engines and diesel engines are likely to be the primary equipment choice for commercial cogeneration. Combustion turbines are large (greater than about 1 MW) and cost about $900 to $1,000/Kw. Thus, investors would be facing equipment costs of about $1,000,000 to install one of these units. Spark ignition engines (similar to large gasoline-fuel truck engines) are insufficiently sturdy to warrant their use in continuous duty cogeneration. Despite the low capital costs for spark ignition engines compared with those for diesel engines, repair and maintenance costs for the former are substantially higher.
>
> Commercial cogeneration users will use natural gas as a fuel for dual-fuel engines whenever gas is available or less expensive than diesel fuel. In rural areas and in some urban areas of the Middle Atlantic region, natural gas is not available and distillate fuel use is expected. Thus, in these areas cogenerators will choose diesel engines. In large urban areas, because natural gas is available for potential cogenerators, cogenerators will install dual-fuel engines to take advantage of low-priced natural gas, even though a dual-fuel engine costs 20% to 30% more initially. We cannot precisely estimate the percent of the 2,500 MW of capacity that will be found in large urban areas. We estimate, however, that cogeneration in larger urban regions may account for 25 percent to 75 percent of the total.[25]

If gas is available for commercial or residential use in urban areas in the Middle Atlantic region, the installation of a great number of dual-fuel cogeneration engines in these areas might adversely affect the environment. Pending further environmen-

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25 EA, *supra*, Appendix C, *mimeo* at 7.

tal analysis, the Commission has decided to require that dual-fuel cogeneration facilities obtain qualification on a case-by-case basis, pursuant to the procedures set forth in section 292.207(b) of the Commission's rules. Before permitting new dual-fuel facilities to qualify, the Commission will consider the emission characteristics of the facility, and the number of qualifying cogeneration facilities in the vicinity of the applicant.

The Commission Orders:

(A) To the extent not granted above, the applications for rehearing and reconsideration of Order Nos. 69 and 70 filed by Southern Company Services, American Electric Power Service Corporation, Edison Electric Institute, Consolidated Edison Company, Boston Edison Company, Colorado-Ute Electric Association, Inc., Elizabethtown Gas Company and Southern California Gas Company are denied.

(B) Sections 292.202, 292.203, 292.204, and 292.601 are amended as set forth below effective on May 15, 1980.

(Public Utility Regulatory Polcies [sic] Act of 1978, 16 U.S.C. § 2601, *et seq.*; Energy Supply and Environmental Coordination Act, 15 U.S.C. § 791 *et seq.*; Federal Power Act, as amended, 16 U.S.C. § 792 *et seq.*, Department of Energy Organization Act, 42 U.S.C. § 7101 *et seq.*; E.O. 12009, 3 C.F.R. 142 (1978).)

In consideration of the foregoing, the Commission amends Part 292 of Chapter I, Title 18, Code of Federal Regulation, as set forth below, effective May 15, 1980.

By the Commission.
(SEAL)

KENNETH F. PLUMB,
Secretary.

1. Section 292.202 is amended in paragraph (j), to read as follows:

§ 292.202 *Definition.*

* * * * *

(j) "total energy input" means the total energy of all forms supplied from external sources.

* * * * *

2. Section 292.203 is amended in paragraph (j) by adding at the end thereof a new subparagraph (2) to read as follows.

§ 292.203 *General requirements for qualification.*

* * * * *

(c) *Interim exclusion.*

* * * * *

(3) Pending further Commission action, any cogeneration facility which is a new dual-fuel cogeneration facility which seeks to obtain qualifying status must follow the procedures set forth in § 292.207(b) of this section.

(4) A new dual-fuel cogeneration facility is a cogeneration facility:

(i) which derives its useful power output from an internal combustion piston engine capable of changing automatically between gas and oil operation, and

(ii) the installation of which began on or after May 15, 1980.

* * * * *

3. Section 292.204 is amended in paragraph (b)(1)(i) to read as follows:

§ 292.204 *Criteria for qualifying small power production facilities.*

* * * * *

(b) *Fuel use.* (1)(i) The primary energy source of the facility must be biomass, waste, renewable resources, or any combination thereof, and more than 75 percent of the total energy input must be from these sources.

* * * * *

4. Section 292.601 is amended in paragraph (b)(1), to read as follows:

§ 292.601 *Exemption to qualifying facilities from the Federal Power Act.*

* * * * *

(b) *General rule.* Any qualifying facility described in paragraph (a) shall be exempt from all sections of the Federal Power Act, except:

(1) sections 1-18, and 21-30;

* * * * *

UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

No. 80-1789—September Term, 1981

AMERICAN ELECTRIC POWER SERVICE CORPORATION, et al.,
Petitioners,

—v.—

FEDERAL ENERGY REGULATORY COMMISSION,
Respondent.

Petition for Review of Orders of the
Federal Energy Regulatory Commission

Before: ROBINSON, *Chief Judge,* WILKEY and
GINSBURG, *Circuit Judges*

JUDGMENT

This cause came on to be heard on a petition for review of orders of the Federal Energy Regulatory Commission, and was argued by counsel. On consideration, thereof, it is

ORDERED AND ADJUDGED by this Court that the orders of the Federal Energy Regulatory Commission are affirmed in part and vacated in part, in accordance with the opinion of this Court filed herein this date.

Per Curiam
For the Court

S/ GEORGE A. FISHER
Clerk

Date: January 22, 1982

Opinion for the Court filed by Circuit Judge Wilkey.

UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

No. 80-1789—September Term, 1981

ARGUED: 9-15-81

AMERICAN ELECTRIC POWER SERVICE CORPORATION, et al.,
Petitioners,

—v.—

FEDERAL ENERGY REGULATORY COMMISSION,
Respondent,

ELIZABETHTOWN GAS COMPANY,
AMERICAN PAPER INSTITUTE, INC.,
BROOKLYN UNION GAS CO.,
OCCIDENTAL GEOTHERMAL, INC.,
Intervenors.

Before: ROBINSON, *Chief Judge,* WILKEY AND GINSBURG,
Circuit Judges

ORDER

On consideration of respondent's petition for rehearing and of the brief of the American Paper Institute, Inc., in support thereof, it is

ORDERED by the Court that the petition for rehearing is denied.

A statement of the panel is attached.

Per Curiam

FOR THE COURT:

GEORGE A. FISHER, *Clerk*

By: S/ ROBERT A. BONNER
Robert A. Bonner
Chief Deputy Clerk

MEMORANDUM

In view of the distortions of the court's opinion served up in the petition for rehearing and suggestion for rehearing en banc filed by the Federal Energy Regulatory Commission (FERC or Commission), We believe it appropriate to restate the essence of the court's decision. FERC attacks two portions of the decision: (1) the disposition of the full avoided cost rule; (2) the rejection of FERC's grant of blanket authority to co-generators to "interconnect" with electric utilities. The Commission, with respect to both challenges, has read into the opinion much more than the court put there.

As to "avoided cost," FERC charges the court with having declared the Commission's rule "inconsistent with the statute." Petition at 2. The court did no such thing. It simply remanded the matter because the Commission had failed to explain "its rationale and process of consideration." Slip op. at 10.* The

* The court noted particularly that FERC adopted as its rule the upper limit Congress authorized and did not clarify whether it considered and, if so, why it rejected a more flexible approach, for example, "permit[ting] state commissions to set rates within a range—*e.g.*, 80-100 percent [of full avoided cost]—authorized by the Commission." Slip op. at 13-14.

opinion plainly states that "[t]he Commission may be right in its conclusion, but it needs to make its reasoning and findings explicit." Slip op. at 12. Some of the suggested considerations expressed in the opinion may indeed have ready answers. *See* slip op. at 14-18. If that is so, it should not be burdensome for FERC to supply them. But the central point made by the court, that FERC never bothered to present a cogent justification of its rule in light of the statutory instructions, slip op. at 10-14, is not vulnerable to the broadside that the court acted "out-of-bounds." Petition at 10. Nor is a petition for rehearing the proper place to supply the reasoned explanation the court's opinion requires.

FERC takes similar liberties with the court's treatment of the "interconnection" issue. The Commission apparently acknowledges that the court correctly conveyed the literal meaning of the statutory sections in question, but complains that the "necessary consequence" of such a literal reading is to force "full dress evidentiary adjudication." Petition at 14. The "consequence" FERC describes, however, is not inevitable. As the opinion points out: "[T]he Commission need not impose substantial administrative burdens . . . but rather can adopt streamlined procedures. If . . . even streamlined procedures are too burdensome, the necessary amendment must come from Congress." The court was not insensitive to the objective FERC sought to accomplish, but as the opinion points out, a court is not the proper forum to repair a congressional product that may have been less than fully considered.

B-205

UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

No. 80-1789—September Term, 1981

Argued: 9-15-81

AMERICAN ELECTRIC POWER SERVICE CORPORATION, et al.,
Petitioners,

—v.—

FEDERAL ENERGY REGULATORY COMMISSION,
Respondent,

ELIZABETHTOWN GAS COMPANY,
AMERICAN PAPER INSTITUTE, INC.,
BROOKLYN UNION GAS CO.,
OCCIDENTAL GEOTHERMAL, INC.,
Intervenors.

Before:
ROBINSON, *Chief Judge,* WRIGHT, TAMM, MACKINNON,
ROBB, WILKEY, WALD, MIKVA, EDWARDS, GINSBURG
and BORK, *Circuit Judges*

ORDER

Respondent's suggestion for rehearing *en banc* and the brief of the American Paper Institute, Inc., in support thereof have

been circulated to the full Court and a majority of the Court has not voted in favor thereof. On consideration of the foregoing, it is

ORDERED by the Court that the aforesaid suggestion is denied.

Per Curiam

FOR THE COURT:

GEORGE A. FISHER, *Clerk*

By: S/ ROBERT A. BONNER
Robert A. Bonner
Chief Deputy Clerk

Circuit Judges Wright, Tamm, MacKinnon, Robb, Edwards and Bork did not participate in this order.

Circuit Judges Wald and Mikva would grant the suggestion for rehearing *en banc*. Their statement is attached.

We would rehear the case *en banc* because of the importance of the issues to major new energy programs of cogeneration and small power production and because of serious doubts over the panel's resolution of those issues. The main issue before the court is whether the Federal Energy Regulatory Commission ("Commission") acted arbitrarily and capriciously by choosing a rate that it believed would provide the greatest incentives for cogeneration, as well as the greatest incentives to decrease our national reliance on fossil fuels, without leading to any increase in rates paid by electric utility consumers. The Commission explained that its fully avoided

cost rule would serve these goals.[1] The panel rejected the Commission's determination for failure to explain adequately how utility consumers' interests had been accommodated, specifically with respect to rejection of one particular alternative to fully avoided costs. As we read the Commission's opinion, however, it found that the appropriate balance of statutory interests had been struck in a rate that would encourage cogeneration without raising rates to consumers. This determination seems reasonable, and we doubt that any further explanation, especially in the way of factual findings, *see* slip op. at 13, was necessary to satisfy the requirements of the Administrative Procedure Act, 5 U.S.C. § 706(2)(A).[2]

The panel's resolution of the interconnection issue is also troubling. The panel has interpreted an incredibly complex and ambiguous interlace of statutory sections to require a fullscale

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1 Although the Commission did not expressly address the interests of consumers in its discussion of the fixed percentage method, *see* R. 3460, it discussed the impact of a full avoided cost method on these interests in its discussion of the comments made to the Commission. The Commission stated:

> Although use of the full avoided cost standard will not produce any rate savings to the utility's customers, several commenters stated that these ratepayers and the nation as a whole will benefit from the decreased reliance on scarce fossil fuels, such as oil and gas, and the more efficient use of energy.
>
> The Commission notes that, in most instances, if part of the savings from cogeneration and small power production were allocated among the utilities' ratepayers, any rate reductions will be insignificant for any individual customer. On the other hand, if these savings are allocated to the relatively small class of qualifying cogenerators and small power producers, they may provide a significant incentive for a higher growth rate of these technologies.

R. 3457-58.

2 The panel's opinion appears to assume that the substantial evidence test governs review of rules promulgated under the Public Utility and Regulatory Policies Act of 1978, Pub. L. No. 95-617, 92 Stat. 3117 ("PURPA"). *See* slip op. at 13 (*citing* Public Sys. v. FERC, 606 F.2d 973 (D.C. Cir. 1979)). PURPA, however, does not set forth a heightened standard of review. The avoided cost rule is therefore subject to the general requirements of the APA, and may be overturned if it is "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law." 5 U.S.C. § 706(2)(A).

evidentiary hearing prior to any interconnections for the sale or purchase of cogenerated power.[3] In so doing, it has rejected FERC's alternative interpretation of the statute that would simply prevent the Commission from *requiring* a cogenerator to interconnect without providing for an evidentiary hearing. The alternative interpretation is a plausible one and appears to be more closely in line with Congress' expressed desire to encourage cogeneration. This alternative reading should receive closer scrutiny by this court before it erects a formidable, perhaps insurmountable, roadblock to a major energy program.

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3 The panel asserts that the Commission could adopt "streamlined" procedures, *see* slip op. at 25, but fails to explain how anything less than an evidentiary hearing would satisfy the requirements it imports from section 210 of the Federal Power Act, 16 U.S.C. § 824i.

Office - Supreme Court, U.S.
FILED
DEC 6 1982
ALEXANDER L. STEVAS,
CLERK

Nos. 82-81 and 82-236

In the Supreme Court of the United States

OCTOBER TERM, 1982

AMERICAN PAPER INSTITUTE, INC.

v.

AMERICAN ELECTRIC POWER SERVICE CORP., *et al.*

FEDERAL ENERGY REGULATORY COMMISSION

v.

AMERICAN ELECTRIC POWER SERVICE CORP., *et al.*

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

JOINT APPENDIX

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Petitions For Certiorari filed July 9, 1982 and August 9, 1982
Petitions For Certiorari granted October 12, 1982

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LIST OF RELEVANT DOCKET ENTRIES IN THE COURT OF APPEALS

1. Petition of American Electric Power Service Corp., Consolidated Edison Company of New York, Inc., and Colorado Ute Electric Association, Inc., for review of Federal Energy Regulatory Commission Order Nos. 69 and 70. Filed July 14, 1980.
2. Order granting motions of American Paper Institute, Inc., Elizabethtown Gas Company and Brooklyn Union Gas Company, for leave to interevene. Entered August 21, 1980. This order is reproduced herein at 2.
3. Order granting motion of Occidential Geothermal, Inc. to intervene out of time. Entered March 25, 1981. This order is reproduced herein at 3.
4. Opinion of the Court of Appeals. Filed January 22, 1982. The opinion is reproduced in the Petitioner's Appendix at B-1 to B-134.
5. Judgment of the Court of Appeals. Filed January 22, 1982. The judgment is reproduced in the Petitioner's Appendix at B-200 to B-201.
6. Order and Memorandum of the Court of Appeals denying petitions for rehearing. Filed April 9, 1982. The order and memorandum is reproduced in the Petitioner's Appendix at B-202 to B-204.
7. Order of the Court of Appeals denying suggestions for rehearing *en banc*, and Memorandum of dissenting judges. Filed April 9, 1982. The order and memorandum is reproduced in the Appendix at B-205 to B-208.

UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT
SEPTEMBER TERM, 1979

No. 80-1789

Filed: August 21, 1980

AMERICAN ELECTRIC POWER SERVICE CORPORATION, ET AL., PETITIONERS

v.

FEDERAL ENERGY REGULATORY COMMISSION, RESPONDENT

AND CONSOLIDATED CASE NO. 80-1531

ORDER

On consideration of the motions of (1) Elizabethtown Gas Company (2) The American Paper Institute, Inc. ("API") and (3) The Brooklyn Union Gas Company ("Movant") for leave to intervene in No. 80–1789, it is

ORDERED that the aforesaid motions for leave to intervene are granted.

Counsel for the aforesaid intervenors may participate in oral argument only to the extent allowable under Rule 12 of the General Rules of this Court.

In order to provide for maximum utilization of the provisions of Rule 28(i) of the Federal Rules of Appellate Procedure, the time for filing the brief(s) of the intervenors is extended until fifteen (15) days after the briefs are filed by the principal party whose position they support. For the purposes of Rule 31(a), the time for filing the next brief will run from that date.

For the Court

GEORGE A. FISHER, CLERK

By: /S/ DANIEL M. CATHEY
First Deputy Clerk

UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT
SEPTEMBER TERM, 1980

No. 80-1789

Filed: March 25, 1981

AMERICAN ELECTRIC POWER SERVICE CORPORATION, ET AL., PETITIONERS

v.

FEDERAL ENERGY REGULATORY COMMISSION, RESPONDENT

ELIZABETHTOWN GAS COMPANY, AMERICAN PAPER INSTITUTE, INC. BROOKLYN UNION GAS CO., INTERVENORS

ORDER

The Clerk is directed to file the motion of Occidental Geothermal, Inc., to intervene out of time, on consideration thereof, and it appearing that the motion is unopposed and that the movant will comply with the briefing schedule set in this case, it is

ORDERED that the aforesaid motion for leave to intervene is granted.

Counsel for the aforesaid intervenor may participate in oral argument only to the extent allowable under Rule 12 of the General Rules of this Court.

For The Court

GEORGE A. FISHER, CLERK

By: /S/ DANIEL M. CATHEY
First Deputy Clerk

LIST OF RELEVANT DOCKET ENTRIES AT THE FEDERAL ENERGY REGULATORY COMMISSION (FERC Docket No. RM 79-55)

Date

1979

June 26 — Staff Paper (44 F.R. 38863), discussing Commission Responsibilities to establish rules regarding rates and exemptions for qualifying cogeneration and small power production facilities pursuant to Section 210 of the Public Utility Regulatory Policies Act of 1978.

July 23 — Notice of Regional Hearings (44 F.R. 44177):

7/23/79—Room 5048, California State Building
350 McAllister Street
San Francisco, California

7/27/79—(Room to be designated)
Everett McKinley Dirksen, Building
219 South Dearborn
Chicago, Illinois

7/30/79—Federal Energy Regulatory Commission,
Hearing Room A
825 North Capitol Street
Washington, D.C. 20426

8/1/79—Comments Due

Sept. 28 — Notice (44 F.R. 57107), setting public hearing to be held on the following dates in the designated cities:

10/17/79—New Orleans, Louisiana
10/24/79—Washington, D.C.
10/26/79—Boston, Massachusetts
10/17/79—Requests to participate to be filed

Oct. 18 — Notice of Proposed Rulemaking (44 F.R. 61190) issued regarding the implementation of Section 210 of the Public Utility Regulatory Policies Act of 1978.

Oct. 23 — Notice issued (44 F.R. 61977), setting public hearings to be held on the following dates in the designated cities:

11/19/79—Seattle, Washington,
11/28/79—New York, New York
11/30/79—Denver, Colorado
12/3/79—Washington, D.C.
11/15/79—Requests to participate

1980

Jan. 30 — Notice issued (45 F.R. 7819), of meeting with State Regulatory Commissioners on Staff Draft of The Final Rule.

2/4/80—Meeting from 2:00 to 5:00 p.m. in Room 9306, 825 North Capitol Street

Feb. 5 Notice issued (45 F.R. 8665), of meeting with Representatives of The Electric Utility Industry on Staff Draft of The Final Rule.

2/8/80—Meeting to be held from 9:00 to 12:00, in Room 2005 of FERC, 825 North Capitol Street.

Feb. 19 Order No. 69 and Final Rule issued (45 F.R. 12214), regarding the Implementation of Section 210 of the Public Utility Regulatory Policies Act.

Mar. 31 Notice (45 F.R. 23661) of Finding of No Significant impact and notice of intent to prepare environmental impact statement issued.

May 15 Order issued (45 F.R. 38958) granting in part and denying in part rehearing of Order Nos. 69 and 70, and amending regulations.

May 29 Notice issued (45 F.R. 38040) setting conference as listed below concerning state implementation of small power production and cogeneration facilities:

6/17/80—Ramada Inn Airport at 8:30 a.m. to 5:30 p.m. Logan International Airport

6/20/80—Ramada Inn Airport at 8:30 a.m. to 5:30 p.m. Atlanta, Georgia

6/23/80—Holiday Inn Airport at 8:30 a.m. to 5:30 p.m. Boise, Idaho

6/25/80—Rodeway Inn (at Airport) at 8:30 a.m. to 5:30 p.m. Minneapolis/St. Paul, Minnesota

6/27/80—Holiday Inn Airport at 8:30 a.m. to 5:30 p.m. St. Louis, Missouri

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PROPOSED RULES

[18 CFR Part 292]

[Docket No. RM79-55]

Staff Paper Discussing Commission Responsibilities To Establish Rules Regarding Rates and Exemptions for Qualifying Cogeneration and Small Power Production Facilities Pursuant to Section 210 of the Public Utility Regulatory Policies Act of 1978

Agency: Federal Energy Regulatory Commission.

ACTION: Staff paper issued, by direction of the Commission, for comment.

SUMMARY: This paper discusses the Commission's responsibilities to issue final rules pursuant to section 210 of the Public Utility Regulatory Policies Act of 1978 (PURPA) relating to the rates at which power should be exchanged between qualifying cogeneration and small power production facilities and eletric utilities and the criteria under which certain qualifying facilities should be exempt from certain State and federal regulations.

DATE: Comments are due by August 1, 1979.

ADDRESS: All comments to: Secretary, Federal Energy Regulatory Commission, 825 North Capitol Street, N.E., Washington, D.C. 20426 (Reference Docket No. RM79-55).

FOR FURTHER INFORMATION CONTACT:

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June 26, 1979.

Memorandum to: The Commission.

From: John B. O'Sullivan, Chief Advisory Counsel; Robert E. Cackowski, Deputy Director, OEPR.

Subject: Section 210 of the Public Utility Regulatory Policies Act of 1978, Concerning Cogeneration and Small Power Production Facilities.

This memorandum is intended to serve as a discussion paper on Section 210 of the Public Utility Regulatory Policies Act of 1978 (PURPA). The memorandum will describe this section of the law, our preliminary view as to how the law might actually work, and some problems that might develop in implementation.

Introduction

Under the Federal Power Act (FPA), sales from cogenerators and small power producers to a public utility (as defined in Part II of the FPA) would, so long as the electricity might make its way into the bulk power transmission grid, make the cogenerator or small power producer itself a public utility. In other words, by virtue of its sale for resale in interstate commerce, the cogenerator or small power producer would itself become a public utility under Part II of the Power Act. Prior to the enactment of PURPA, the FERC was not authorized to abstain, in whole or in part, from exercising its jurisdiction over such cogenerator-public utilities and small power producer-public utilities. The prospect of plenary regulation unquestionably acted as a powerful disincentive to the generation and sale of surplus power by such facilities, particularly where the owner was an industrial concern unfamiliar with the arcane intricacies of utility regulation. It should be noted that sales of supplemental or back-up power to such cogenerators and small power producers by the local public utility would in most instances be a retail sale regulated by the State.

In Sections 201 and 210 of PURPA, Congress has grappled with both the split jurisdiction and the disincentive to certain desirable kinds of electric generation imposed by

the rigid jurisdictional provisions of the FPA, as well as with allegations that some utilities were not dealing in good faith with certain existing or proposed cogenerators and small power producers. The PURPA scheme, though certainly novel in the context of traditional utility regulation and probably complex to administer, is a logical approach to solving the problems with which Congress was concerned.

Section 201 of PURPA generally defines a "qualifying small power production facility," "qualifying small power producer," "qualifying cogeneration facility," and "qualifying cogenerator." The Commission is to establish by rule the detailed criteria for qualifying facilities of both types. Generally, a qualifying small power production facility (SPPF) can only use biomass, waste, renewable resources (including hydro from existing dams), or a combination thereof, as a primary energy source; and, together with other facilities at the same site, cannot have a capacity greater than 80 megawatts. A cogeneration facility is defined as a facility which produces both electricity and steam or some other useful form of energy, such as heat. There is no size limit for qualifying cogeneration facilities. A qualifying facility of either type must be "owned by a person not primarily engaged in the generation or sale of electric power (other than electric power solely from cogeneration facilities or small power production facilities)."[1]

Having delineated by Section 201 and the Commission rules promulgated thereunder the class with which it was dealing, the Congress provided certain substantial benefits of qualification in Section 210. Broadly stated, these benefits are the following:

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[1] However, a utility or a number or utilities may participate in the ownership of a facility; and nothing in the statute bars a utilit; from operating a qualifying facility. In fact, a utility operating such a facility which it did not own would become a "qualifying cogenerator" or "qualifying small power producer."

(1) Electric utilities (defined as any person, State agency or Federal agency which sells electric energy)[2] can be compelled to buy power from qualifying facilities. The price applied to such required purchases must be just and reasonable to the customers of the purchasing utility and in the public interest. The Commission may not prescribe a price for such sales that "exceeds the incremental cost to the electric utility of alternative electric energy." The price shall not discriminate against the selling qualifying cogenerator or small power producer.

(2) Utilities can be compelled to sell to qualifying facilities. The price applied to such required sales shall be just and reasonable and in the public interest and shall not discriminate against the qualifying cogenerator or small power producer.

(3) Qualifying small power production facilities whose size does not exceed 30 megawatts of capacity and all qualifying cogeneration facilities may be exempted in whole or in part by Commission rule from the Federal Power Act, from the Public Utility Holding Company Act, and from State laws and regulations respecting the financial or organization regulation of public utilities, if the Commission determines such exemption is necessary to encourage cogeneration and small power production.

Rules embodying these principles are to be issued by the Commission within one year after enactment; *viz*, by November 8, 1979. The law provides that the State regulatory authorities and nonregulated utilities are to implement the Commission's rules within a year after they are prescribed.

As this bare-bones description of the statute may or may not make apparent, there is the potential, if not a requirement, for a fundamental reordering of the traditional dual

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[2] The definition of electric utility applicable to Section 210 is that which appears in Title I of PURPA (and which includes the Federal power marketing agencies), not the Title II definition (which does not). The Title II definition (from PURPA § 201) has become a part of the Federal Power Act (specifically, § 3(22)), and thus applies to the parts of PURPA which amend the Power Act. Section 3(4) of PURPA establishes the definition to be applied to those parts of PURPA which, like Section 210, are not made a part of the Federal Power Act.

regulatory scheme as it applies to certain cogenerators and small power producers.[3] Whereas before the FERC had jurisdiction over sales from such power producers for resale in interstate commerce, while the states regulated retail sales, PURPA provides for FERC rules governing *both* transactions. And the states, which have not had jurisdiction over sales for resale in interstate commerce, will in all likelihood carry out the day-to-day regulation of such sales where they involve qualifying facilities (QFs) in addition to continuing to regulate all retail sales, including sales to QFs. However, the regulation of transactions involving QFs may well be conducted under the state regulations implementing the FERC's rules promulgated pursuant to Section 210, rather than under State laws. In other words, the requirement that the States and nonregulated utilities implement the FERC's rules, together with the FERC's authority to exempt QFs from some or all of Parts II and III of the FPA and from State law could (and almost certainly will) result in the delegation-by-exemption to the States of both old and new FERC regulatory responsibilities.

The second major departure from or reordering of traditional utility regulation inherent in the Section 210 scheme is a consequence of the Congress's intention to avoid the treatment of qualifying cogenerators and small power producers as utilities, where such treatment is a disincentive to these kinds of generation. Traditional regulation has, naturally, focused on the seller. For the most part, regulators regulate the public utility, not its customers. There is plentiful precedent for a requirement to sell (Sections 202(b) and (c) of the FPA, virtually all State laws concerning service to retail customer), but almost none for required purchases of the sort provided for in Section 210. Similarly, under conventional regulation, the seller's rates are subject to regulatory approval, the test of the reasonableness of which is the seller's costs. Here, because of the effort to relieve some generators of the burdens of regula-

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[3] Except where a precise point of statutory construction is being discussed, we will use the terms "cogenerator" and "small power producer", interchangeably with, respectively. "cogeneration facility" and "small power production facility."

tion. Congress has established a scheme in which the primary reference point for determining the price for a sale from a QF to a utility is not the seller's cost but the buyer's avoided cost. Indeed, the Congress has specifically instructed FERC that QFs are not to be subjected to the same scrutiny and requirements for organization and reporting as regular utilities; and the authority to grant exemptions is the device which Congress has given the Commission not only to avoid such regulation on its own part, but also to ensure that once the Federal preemption of such regulation is removed, the States do not begin to regulate QFs as utilities.

All this is not to say that there is a lack of precedent for the Commission, State regulators, and nonregulated utilities to look to in implementing Section 210 of PURPA. Many utilities have experience with their own cogeneration (primarily those that provide district heat steam service.) With regard to the sale from a utility to a qualifying facility, the primary model is conventional State-regulated retail sales, though in some instances partial requirements or interchange wholesale rates provide a better basis of comparison. With regard to the sale from a qualifying facility to an electric utility, wholesale rates probably provide the best analogy in most cases, particularly where a relationship between a utility and a number of qualifying facilities begins to resemble a power pool. Useful information may also be gleaned from the not-uncommon arrangement whereby a utility purchases power from an industrial cogenerator or self-generator. A number of States have already begun work on rules concerning cogenerators and a few are quite far along this road, and this also can provide substantial guidance.

Nonetheless, it is fair to say that in many instances the transactions between utilities and those who will qualify under Section 201 have in the past fallen into a gap between the FPC/FERC and State regulators. It is certain that the terms under which these transactions take place vary enormously from utility to utility and region to region. In the following more detailed discussion, we will not attempt to provide in all instances a single correct or even preferred

approach to implementation. Because of regional differences in circumstances, the enormous range of characteristics as to both loads and power production likely to be exhibited by various qualifying facilities, and simple uncertainty as to what the law means or what the best approach to a problem is, we will often merely list some apparent alternatives. By this we do not mean to imply that the Commission will in every case ultimately be faced with making a choice of a single approach from among a number of alternatives. It is quite likely that the Commission will want to leave the States and the nonregulated utilities flexibility for experimentation and accommodation of special circumstances on a number of these matters.

With respect to the nonregulated utilities, consideration will be given as to the necessity of a separate set of rules from that applicable to the State commissions due to the fact that the nonregulated electric utility will be both the entity responsible for implementing the Commission's rules and the utility directly dealing with the cogenerator or small power producer.

Exemptions

Section 210 directs the Commission within a year of enactment to prescribe rules exempting small power production facilities with no more than 30 megawatts of capacity and all cogenerators from part or all of the Federal Power Act, from the Public Utility Holding Company Act, and from State laws and regulations respecting the rates or respecting the financial or organizational regulation of utilities, if the Commission determines such exemption is necessary to encourage cogeneration and small power production. Small power production facilities of greater than 30 megawatt capacity using biomass exclusively as a primary energy source may be exempted from the Holding Company Act and State laws, but not from the Federal Power Act.[4] Under 210(e)(3), no QF can be exempted from Part I

[4] Thus the Commission is not authorized to exempt small power production facilities of 30 to 80 megawatt capacity from any of these laws, with the exception of biomass users who still canot be exempted from the FPA. As a technical matter, this would leave in place two conflict-

of the Power Act, Sections 210,211 and 212 of the Power Act (added by Sections 202, 203 and 204 of PURPA, and having to do with interconnection and wheeling), and State laws and regulations implementing the Commission's rules promulgated pursuant to Section 210.

It is clear from the Conference Report that Congress intended the Commission to make liberal use of its exemption authority:

> The conferees wish to make clear that cogeneration is to be encouraged under this section and therefore the examination of the level of rates which should apply to the purchase by the utility of the cogenerator's or small power producer's power should not be burdened by the same examination as are utility rate applications * * *. The conferees expect that the establishment of utility type regulation over them would act as a significant disincentive to firms interested in cogeneration and small power production.

Although we have not conducted an exhaustive survey, there is good reason to believe that many if not most State laws provide for regulation of cogeneration and small power production facilities as utilities. These State laws have been rendered ineffective in most instances because of the FPA preemption of regulation of sales for resale in interstate commerce. Were the Commission to exempt QFs from FPA regulation, but not from State regulation, the State laws would then take effect, frustrating the intent of Congress that QFs not be subjected to same scrutiny and organizational requirements as utilities. It would be difficult to maintain that the Federal preemption continued even after

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ing regulatory schemes covering this group: Section 210 pricing, and traditional Federal Power Act regulation of the QSPP who becomes a Part II public utility by virtue of a wholesale sale into interstate commerce. The Conference Report resolves this for the most part by instructing the Commission to use Section 210 pricing for this group. Left unresolved are two questions: (1) What will be the effect of State regulation on small power producers of greater than 30 megawatts who are making sales for resale but not into interstate commerce (such as in Alaska, Hawaii, Puerto Rico and most of Texas)? and (2) Should the Commission exempt biomass small power producers in these areas from State regulation, where the consequence is that they will not be regulated at all?

the Commission exempted QFs from the FPA (that is, that the area was deliberately left vacant, and that the States could not then occupy the area) if the Commission chose not to exercise its authority to exempt from State regulation. Therefore, it seems likely that in the great majority of cases where the Commission provides an exemption from the FPA it will also want to provide substantial exemptions from State law.[5]

Basically, there are two approaches that can be taken to the State law exemption. The first, which is both more precise and more cumbersome, is to analyze the laws of each State and specify the exemptions to be provided citing sections of State law and regulations. We do not recommend this approach, except possibly for the noncontiguous states and territories and contiguous areas not hooked into the interstate grid (primarily parts of Texas). The second approach is to make a broad prescription exempting from any and all provisions of State law and regulations as would conflict with the State's implementation of the Commission's rules under Section 210. This approach, while it may lead to some disputes which the Commission will have to become involved in, has the advantages of simplicity, administrative ease, and permanence (*i.e.*, the language of the exemption would have to be changed every time a State changed its laws or regulations).

While the proper course seems obvious with regard to Federal and State rate regulation and the requirements for filing voluminous reports concerning operation, cost and

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[5] Note that the Commission does not have the authority to exempt cogenerators from State regulation as a steam utility. This fact may have somewhat disparate consequences (assuming that some cogenerators may be interested in selling steam), since some States do not regulate steam sales, some do so only if the seller is already a utility, and some do so whether or not the seller is an electric utility.

A quite different and somewhat anomalous situation involving preemption may arise if a State has by statute directed the State regulatory authority not to regulate cogenerators. The most reasonable approach to this situation would seem to be to treat the State law as consistent with Section 210 of PURPA, in that (as the Introduction points out) it is really the utility as buyer and seller that is regulated.

revenue data,[6] the matter of exemption from provisions of the FPA concerning financing and related matters and from the Public Utility Holding Company Act is not nearly so clear. Pending consultation with the Staff of the Securities and Exchange Commission, we will not attempt an exhaustive analysis of this subject. However, as a rule of thumb it seems reasonable to provide that where a firm is subjected to more stringent regulation than other companies simply because it is engaged in electric utility business, those requirements should be eased through exemptions for QFs; but where a certain kind of regulation is applied to electric companies under the FPA or the Public Utility Holding Company Act, and applied in equal measure to non-utilities under other statutes enforced by the S.E.C., the argument for exemption is not nearly so strong. An example of the former, utility-only kind of provision is the requirement that a holding company show that its subsidiaries are or are capable of being operated on an integrated basis. In this case, we think, exemption warranted. By contrast, exemption from certain security acquisition and interlocking directorship provisions may not be warranted.

As the Conference Report indicates, some participation by one or more utilities in the ownership of qualifying facilities may be permitted by the Commission's Section 201 rules. However, an exemption granted to a facility under 210(e) would not serve to release a utility or holding company participating in some way in a QF's ownership from any other unrelated obligations it may have under the law, since Section 210 permits the exemption of the QF, not of a parent (or grandparent). (In this context, we take this to mean that where a facility is granted an exemption, participation in the ownership of the facility will not give rise to a particular legal obligation that would have otherwise attached). We interpret 210(e) as giving the Commission sufficient flexibility to grant an exemption such that a non-utility parent is relieved of certain obligations while a

[6] Though it is worth noting that some exemptions here will affect the data provided to the Energy Information Administration, where EIA's authority is derived from the Federal Power Act.

utility or holding company participating in the same project is not. Again, the test for an exemption is whether it is "necessary to encourage cogeneration and small power production."

Finally, it should be noted that the exemption of QFs from traditional utility-type regulation, as specifically discussed in the Conference Report, may have the effect of making QFs eligible for a 20% energy investment tax credit. A recent change (March 1979) in Treasury Department regulations permits the exclusion from "public utility property" of property used in the business of the furnishing or sale of electric energy if the rates are not subject to regulation that fixes a rate of return on investment. Prior to the change, any rate regulation made property subject thereto (and involved in the furnishing or sale of electric energy) public utility property. Being thus excluded from public utility property, qualifying facilities have an opportunity to come within the definition of "alternative energy property," and thus qualify for the 20% ITC.

In fact, it may well be that even small power production facilities too large to be exempted may be eligible for the higher tax credit, due to the Conference Report's instruction to set the prices for sales by these SPPFs to utilities "in accordance with the requirements of" Section 210 rather than by "utility-type regulation."

Interconnection

Section 210 requires that utilities buy from and sell to QFs. It does not, however, explicitly provide authority to the Commission to order any interconnection necessary to effect the required transaction. The question thus arises as to whether there is inherent in section 210 of PURPA the authority to order such interconnections, or whether QFs must use Sections 210 and 212 of the FPA (added by Sections 202 and 204 of PURPA) to gain interconnection.

Perhaps the strongest argument against the finding that there is an interconnection authority within the cogeneration section is that the interconnection section itself explicitly lists qualifying cogenerators and small power producers as among those who are eligible to make an application. (By

contrast, the next section, dealing with wheeling, does not confer eligibility on QFs). Moreover, the requirement under Sections 210 and 212 of the FPA that the party seeking interconnection must show himself to be ready, willing and able to pay the resulting costs, and the companion criterion that the interconnection order not be issued if it would result in a reasonably ascertainable uncompensated economic loss for any electric utility, might be seen as consistent with the statement in the Conference Report that the cogeneration section was not to be applied so as to force a utility's customers to subsidize a qualifying facility.

Although this argument is respectable, we think it the better view that the requirement to interconnect is subsumed within the requirement to buy and sell. To hold otherwise would mean that Congress intended to have qualifying facilities go through an extended and expensive proceeding simply to gain interconnection, contrary to the entire thrust of Sections 201 and 210.

These sections evince the clear Congressional intent to encourage development of these desirable forms of generation, and to have the commercial development of these facilities proceed expeditiously. In other words, Congress has already made the judgment that these kinds of facilities serve one of the purposes of the Act as set out in Section 101, *viz*, "the optimization of the efficiency of use of facilities and resources by electric utilities", and it would be both redundant and unduly burdensome to have the sponsors of individual facilities show in an evidentiary hearing (FPA § 210(b)(2)) that their project in particular would serve this end (or one of the other related goals established as criteria for an interconnection order in § 210(c)(2)). After all, the purpose of an interconnection application, whether under Section 202 or 210 of the FPA, is to secure service, whether emergency or otherwise; and Section 210 of PURPA establishes the entitlement of a QF to service from the interconnected utility. In effect, the proponents of the view that a QF must apply under Sections 210 and 212 of the FPA have the burden of showing that Congress intended interconnection and the entitlement to buy and sell be denied to a QF which is unable to make the showings re-

quired by those sections even though a previously-interconnected customer installing qualifying facilities would not have to do so.

This is not to say that all of the protections that Congress has given the target of an interconnection application in Sections 210 and 212 of the FPA are necessarily absent from Section 210 of PURPA. The Conference Report on Section 210 states that customers of utilities are not to be compelled to subsidize QFs, and this principle would seem to bear on the question of who pays the costs of interconnection as well as on the per-unit price to be paid for energy. On the other hand, the conference Report includes a prescription against "unreasonable rate structure impediments, such as *unreasonable hook up charges.*" (emphasis added) This provides another argument in favor of reading Section 210 as including interconnection authority, since the elaborate cost determination required under Sections 210 and 212 of the FPA is redunant if the costs of interconnection are viewed simply as a feature of the rate structure with the charge therefor based on the cost of the utility.

Reliability

Section 210(a) states that the rules requiring utilities to buy from and sell to QFs "shall include provisions respecting minimum reliability of [QFs] (including reliability of such facilities during emergencies) and rules respecting reliability of electric energy service to be available to such facilities from electric utilities during emergencies."

This statutory language raises the question of whether the Commission *must* prescribe minimum reliability requirements for qualifying facilities selling to utilities.

Section 201 specifically mentions reliability as one of the factors the Commission may take into account in establishing the criteria for qualifying small power production facilities. (It is not mentioned in the parallel language concerning co-generators.) We read Section 201 as permitting but not requiring the Commission to establish a minimum standard for the reliability of small power producers. Whether one agrees with this interpretation or believes that the Commission must establish such a threshold, the

question remains as to why the Congress included provisions concerning reliability in Section 210 for both kinds of facilities after having mentioned it in Section 201 as to one kind but not the other.

Of course, the degree of reliability and/or availability can and should be reflected in the price for electric service, whether a utility or a QF is the seller. Putting a price tag on a particular degree of reliability is practically an everyday exercise for utilities and regulatory agencies. Put another way, then, the question is whether the Congress intended the Commission to establish rules on QF reliability under Section 210 that went beyond a requirement that differences in reliability be fully reflected in prices.

The Congress evinced a clear concern that utility customers not be required by the Commission's Section 210 rules to subsidize QFs. The 210(a) language concerning reliability might well have been intended to prevent indirect subsidies resulting either from frivolous or otherwise uneconomical interconnections (with the costs borne by the utility's customers) or from a diminution in the quality of service rendered by a utility due to an interconnected facility's disruption of a utility's operations.

Elsewhere in this memorandum we have recommended that the incremental costs of interconnection or reinforcement of a utility's distribution and transmission facilities (*i.e.*, those costs which the utility would not have incurred in securing the same power from an alternative source, or in providing service to the qualifying facility if the facility did not have its own generation) should be borne by the QF. So long as facilities can be devised which are sufficient to protect the utility from disruption of its operations by a QF—and our present understanding is that such protective devices can always be provided—and the QF rather than the utility bears the costs of these facilities, then no such indirect subsidy would occur.

Our analysis thus leads us to the conclusion that every incidence of a QF's reliability (or unreliability) can be accounted for through prices. If this conclusion withstands the test of public comment, we would recommend to the Commission that it establish no minimum reliability stand-

ard pursuant to Section 210(a), but that it make full provision for the consequences of varying degrees of reliability in the rules on pricing.

It is reasonable to expect many different kinds jof facilities to be covered by and become involved with Section 210, ranging from large, self-sufficient and previously-isolated industrial generators to small, experimental and somewhat exotic facilities. The reliability that these different kinds of QFs will need from utilities and will be able to offer utilities will run the gamut. The needed services may vary from something comparable to a typical firm retail sale to more sophisticated pooling and interconnection arrangements. Similarly the service offered by QFs to electric utilities will range from dump or interruptible energy to firm power sales, *i.e.*, a reliable substitute for capacity that would otherwise be installed by the utility.

It is difficult, if not impossible, to predict what kinds of facilities will present themselves to any given utility. Thus it appears that the approach that would best satisfy the statutory mandate to encourage cogeneration and certain types of small power production is to require all electric utilities to offer to buy and sell services providing a complete range of reliability,[7] with the proviso that in each instance the price will have to be calculated so as to satisfy the other provisions of section 210, including the principle that utility customers not be compelled to subsidize QFs.

This requirement that electric utilities offer a complete menu of services (at appropriate prices) should not be too great a hardship, at least for public utilities, since between their wholesale and retail rate schedules most now offer a broad range of services, including firm all requirements, standby, interruptible and emergency services (though many do not offer what may be the closest parallel in many instances, partial requirements service).

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[7] We do not mean to imply by this that qualifying facilities could rely on this requirement to secure a higher degree of reliability that firm, full requirements customers, or secure for themselves a higher priority than other customers with similar end-uses under a short- or long-term emergency load-shedding plan.

With regard to emergency sales from QFs to utilities, we would note that cogenerators and small power producers can be the subject of an order under Section 202(c) of the FPA to provide energy if the Economic Regulatory Administration determines that an emergency exists. Absent the declaration of a 202(c) emergency, we would recommend leaving the terms of emergency availability to the negotiations of the parties, subject only the rule recommended in the preceding paragraphs.

Sales from Utilities to Qualifying Facilities

Section 210(c) of PURPA provides that:

The rules prescribed under Subsection (a) [which requires, *inter alia*, that utilities sell to QFs] shall insure that in requiring any electric utility to offer to sell electric energy to any qualifying cogeneration facility or qualifying small power production facility, the rates for such sale—

(1) shall be just and reasonable and in the public interest, and

(2) shall not discriminate against the qualifying cogenerators or qualifying small power producers.

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This statutory language is similar to the language contained in Sections 205 and 206 of the FPA and is probably similar to many of the State statutes with respect to utility regulation. Such language thus permits traditional ratemaking concepts with respect to the sales to QFs.

In most instances, it would appear appropriate for the proposed rules to require the States to apply their standard ratemaking concepts in establishing rates for the QFs to the extent possible, even where there is a significant difference between FERC's approach and that of a state. That is, in most instances the test as to whether a QF is being discriminated against *as a utility customer* will be made by comparing the QF to other retail customers of the utility. For example, although California might choose to exempt qualifying facilities from having to pay a share of the subsidy for lifeline rates required of other industrial customers, there does not seem to be a valid argument that the failure to exempt QFs is discriminatory, since the QFs would sim-

ply be treated like others in the class to which they would belong if they did not have their own generation. Similarly, there seems no reason why any steps taken under Title I of PURPA with respect to such matters as time of day rates should not also apply to QFs.

In determining the rates to QFs, one of the first issues likely to arise is whether all or some QFs should be served as a separate rate class or included among a more general class such as the industrial or large power customers. It would appear that latitude should be given in the rules to permit inclusion of QFs within a general rate class to the extent that the load characteristics permit. This may be the most practical approach where the number of potential QFs is relatively small and might not warrant the costs associated with developing a separate rate class. Similarly, latitude should be given to permit classification as a separate rate class if the number of potential customers is large and/or the load characteristics are likely to impose substantially different costs on the system from the general rate class. These general problems of customer classification will of course become less important to the extent the states move to time-of-day rates.

Two major problems arise in the area of customer class assignment due to a shortage of good data. First, a majority of utilities do not have good load data even for their major retail customer classes, and in a number of states neither the utilities nor their regulatory agencies set rates based upon a class cost of service calculation. (The load data problem will be resolved over the long haul for the larger electric utilities by Section 133 of PURPA, which requires the collection of cost and load information by customer class.) Second, even where utilities have good data for their existing major classes, estimates as to the service requirements of QFs, and thus the costs imposed on the utility (determined to a considerable extent by the outages of the customer's own generation and the type of standby service the customer wants), may not at first rise above the level of speculation.

The second problem may be eased substantially over the short run if QFs and utilities can agree to contracts speci-

fying the services the utility will be called on to provide. However, where the two parties cannot reach this kind of agreement (such as where a cogenerator is unsure of its own production and is not willing to contract for interruptible service from the utility for any part of its potential load), the problem remains.

Whether or not a QF agrees to specific contractual levels of service, and whether a QF is assigned to an existing customer class, has a custom-designed individual rate, or is placed in a special class (or one among several special classes) for QFs, the first problem does not seem susceptible of precise solution over the short term. It would seem difficult to declare with any confidence that rates for a particular customer or class of customers is just and reasonable if there is no approved way of determining the customer's cost responsibility; and it would seem to be impossible to determine with any precision whether or not a proposed rate were discriminatroy when one does not know the cost of serving the class or classes whose rates the QF's rates are to be compared to. Indeed, it may even be difficult to determine whether or not some or all QFs should be grouped with a particular class or subclass when little is known about the cost and load characteristics of the class.

Since some cogenerators and small power producers may have operations similar to those of utilities with generating facilities, the rules should provide sufficient latitude to permit interconnection and coordination agreements or partial requirement agreements similar to those subject to this Commission's jurisdiction. This would provide contractually specified operating criteria and would allow a full range of services including the sharing of mutual benefits of diversity and coordination. In fact, wholesale rates may provide some makeshift basis for determining what retail rates are appropriate for QFs where little is known about retail loads and costs by class.

Where large numbers of existing customers are converting their operations from those of a full requirements customer to that of a cognerator or small power producer, such conversion may significantly alter total system loads and costs and almost certainly alter the outcome of a class

cost allocation. To the extent that the conversion increases the total system costs from what they would otherwise be, or, more likely, leaves roughly the same fixed costs to be spread over fewer units sold, the rules should permit consideration of this fact by the states in determining the rates for such customers and the remaining customers on the system.[8] This situation might become a significant factor in determining whether the rates are in tne "public interest" as required by Section 210(c). (The effect on system loads and costs is also an important consideration in determining the rate for power purchased by the utility from the cogenerator or small power producer, as discussed later.].

One of the most often discussed problems of rates for cogenerators or small power producers is the charge for backup or standby service. Here, the question of what costs the customer(s) imposes on the utility, and thus what the appropriate rate is, essentially turns on three factors: first, the reliability of customer's generating equipment, or, put another way, the likelihood that the customer will be unable to supply part or all of his own electricity needs; second, the extent to which the customer will call on the utility to make up such a deficiency; and third, the degree of coincidence between such outages and the utility's peak demands. Cogenerators generally argue for lower backup charges based on the fact that they are unlikely to experience outages all at the same time, whereas the utilities argue for higher charges due to lack of ability to predict the time or duration of an outage since the operation of the facilities is outside a utility control. In part, this argument comes down to prudent utility planning for meeting loads that are potentially volatile and are dependent in part on the maintenance practices of the nonutility operators.

Where there is not a retail class of customers for backup service, with a rate based upon group outage probabilities, or perhaps even where there is such a class, latitude should be given in the rules to permit groups of qualifying cogen-

[8] We do not mean to imply that the entire shortfall, if there be any, should be imposed on QFs; rather, we merely suggest that it does not seem inappropriate for QFs to bear some share of the burden.

erators or small power producers to contractually "pool" their operations among themselves to minimize the potential cost impact on the utilities. By first pooling among themselves, QFs might facilitate individual contractual dealings with utilties and reduce its attendant costs. Pooled QFs certainly could make a much stronger argument that probabilistic analysis should be used in determining the backup charges, and based on the coordination the analysis would show a lowered probability of coincident outages. Such "pooling" might include arrangements such as coordinated maintenance or mutual spinning reserves.[9] The pooled operations could also be coordinated with the utility further to minimize the potential cost impact of outages. Such pooling would entail some sacrifice of the QFs' flexibility in operations, but the resulting lower backup charges may provide a sufficient incentive. To the extent that operations are not coordinated and individual QFs and the group of QFs as a whole impose greater capacity requirements on the utility system, the costs of such backup service should be fully recovered.

In the analysis of and negotiations over backup probabilities and responsibilities, recognition should be given to the fact that some cogenerators will not be able to continue part or all of their industrial operations if their steam (and thus electric) production facilities break down or are closed down. In other words, some cogenerators may not want or need backup for the part of their electric requirements related to industrial processes that also require steam—when there is no steam, they shut down and go home. On a related matter, recognition should be given to a customer's own backup or reserves in the form of redundant capacity. A customer having sufficiently reliable facilities of its own might consider contracting for backup service from the utility on an as-available basis for the portion of its load that it is sure it can supply itself.

[9] Although the latter would arguably reduce backup generating requirements on the utility's system it may not reduce transmission costs.

One likely area of contention that arises in connection with interruptible and standby service is the recovery of the utility's customer or facilities costs. There is likely to be somewhat less debate concerning the magnitude of these costs where the customer is a large industrial or commercial facility, since the design of facilities and determination of their cost is often arrived at on the basis of individual negotiation now even where the customer does not have its own generation. [We will discuss these interconnection costs in the next section.[Where smaller customers are involved, however, the rate design for the class to which the customer is assigned may provide for the recovery of some customer costs through usage charges, and may also provide for the recovery of some capacity costs through energy charges. In these situations, the utility is likely to assert—and with considerable merit—that minimum charges have to be increased so as to ensure the recovery of its fixed costs (and some expenses) from dedicated facilities when the customer does not buy enough energy in a given period to reimburse the utility under the conventional rate design. A minimum bill calculated to recover these costs would seem to be a reasonable approach to this matter, though a discrimination problem might arise if the QF is paying a fully compensatory minimum charge while substantial numbers of customers in the class to which the QF would belong but for its own generation do not return their customer costs.

The final question to be addressed in this section is whether the Commission should specify the kinds of interconnection that should be made available to QFs as customers of a utility. Specifically, the question is whether QFs in general should have an entitlement to operate in parallel with utilities (so that the same customer circuits can be served simultaneously by both customer- and utility-generated electricity), or whether this should be left to the States or the parties (in which case some QFs may be forced to segregate circuits).

In addition to the considerations of cost and possible interference with system operations, there are safety aspects which will require coordination and procedural safeguards.

For example, when certain lines are taken out of service in order to perform maintenance or repairs on such lines, adequate procedures must be in place to ensure that they are not energized by the other party prior to completion of the work. However, on the basis of preliminary discussion it appears that problems of operations, equipment protection and worker safety can all be solved, and that in the final analysis this question mostly concerns cost. Therefore, we recommend that operation in parallel be a required option, so long as the customer is willing to bear the costs of the facilities necessary to protect workers and equipment.

Sales from Qualitying Facilities to Utilities

Section 210(b) of PURPA provides that the Commission's rules shall insure that in requiring any electric utility to offer to purchase electric energy from any qualifying cogeneration facility or qualifying small power production facility, the rates for such purchase—

(1) Shall be just and reasonable to the electric consumers of the purchasing utility and in the public interest, and

(2) Shall not discriminate against qualifying cogenerators or qualifying small power producers.

* * * * *

The statute provides that the rate for required purchases not exceed the incremental cost of alternative electric energy, which is defined as the cost of energy which, but for the purchase, the utility would generate or purchase from another source. The rules may not authorize a QF to make a sale other than for resale, though State law may permit a QF to make such sales.

Perhaps the most important question facing the Commission in the pricing area (but probably not the most difficult question) is whether Section 210 contemplates the payment of capacity charges to QFs under any conditions. Section 210 itself speaks only in terms of "electric energy." While this term does not exclude the payment of capacity charges, it does not clearly include it either. For the most part, the Conference Report also uses the term "electric energy." Even the example given in the Conference Report (in support of the point that the cheapest energy available

at a given time does not necessarily fix the ceiling of the amount to be paid a QF, because the utility may not have intended to use that cheap (hydro) power at the time the sale took place) is cast in terms of energy costs and energy charges.

There is, however, considerable language in both the statute and the Conference Report in support of the proposition that capacity payments are, at least in some circumstances, not only legal but mandated. First, the "incremental cost to the electric utility of alternative electric energy" would, where capacity is purchased or installed, include a capacity cost. If a cogenerator were offering energy of a like reliability for a similar term, the alternative cost would clearly not be limited to, for example, the energy component of the alternative rate where the alternative is a firm or unit purchase. Indeed, one can well argue that to pay the QF a price based only on displaced energy costs where another utility would receive a capacity payment as well for the same service is discriminatory in violation of the statute.

The Conference Report addresses the calculation of the alternative cost standard at some length. The final paragraph of this section of the Report is the following:

The conferees expect that the Commission, in judging whether the electric power supplied by the cogenerator or small power producer will replace future power which the utility would otherwise have to generate itself either through existing capacity or additions to capacity or purchase from other sources, will take into account the reliability of the power supplied by the cogenerator or small power producer by reason of any legally enforcible obligation of such cogenerator or small power producer to supply firm power to the utility.

The references to "additions to capacity" and to obligations "to supply firm power" (the rates for which, in our experience, always include a capacity component) bring us to the conclusion that the better reading of Section 210 is that capacity payments to QFs can be required under certain circumstances; and that, indeed, a utility's refusal to make

payments based in part on avoided capacity payments could be discriminatory.

The paragraph from the Conference cited above also has a message for QF's, however; utilities make capacity payments to each other where firm commitments to make and hold capacity available are involved. A cogenerator or small power producer which is unwilling or unable to make such a commitment and to achieve a high degree of reliability, is not enabling the purchasing utility to avoid the costs of construction or a capacity purchase, and thus these costs do not serve to increase the ceiling on the rates the QF can demand.

In short, the statute provides an upper limit on the price for a capacity purchase (including an energy rate component) at the alternative capacity and energy costs avoided due to such purchase. Among other things, the duration of the purchase, the planning horizon of the utility and the capacity and load situation of the utility will affect such alternative costs. Generation expansion models (which discount the future costs of alternatives to a common present value) may be used to quantify such costs once the magnitude and duration of capacity purchases are known. The composition of such studies would vary depending on the answers to certain questions: Will utilities be required to pay now on a discounted basis for capacity not yet needed? Will capacity sales have priority over dump energy? How far into the future must utilities commit to buy, both as to initiation and duration of the sale?

Interruptible (by the QF) energy sales can be priced a number of ways. Fopr example, a split-the-savings concept similar to economy energy purchases in existing interchange agreements could be employed.[10] Although economy energy is normally priced on an hour-by-hour, transaction-by-transaction basis, consideration should be given to a more general approach with lower administrative costs such as estimated monthly or annual savings. The differ-

[10] This analogy may be of some assistance where a State's fuel adjustment clause rules, like FERC's, permit a complete pass-through to customers of the cost of economy purchases where the cost is lower than that of the displaced fuel.

ence between the cogenerator's out-of-pocket cost and the utility's out-of-pocket cost avoided as a result of the transaction would be shared on an equitable basis between the QF and the utility. Rather than the typical equal split of the savings, latitude should be given to permit negotiations resulting in a greater proportion of the savings going to the cogenerator in order to encourage cogeneration as intended by the statute. So long as the price is less than the alternative cost to the utility, the buying utility's ratepayers benefit from such transactions, and the statute would seem to be satisfied.[11] Such an approach may seem to depart from the Conferees' directive not to scrutinize the costs of QFs as though they were utilities. However, this approach should not generally produce a substantial burden on the QF since in most cases the QF should have calculated its marginal energy cost to determine if it can afford to sell to a utility, particularly at times when the utility's marginal running cost is low. In any case, the statute does not prohibit all inquiry into a QF's costs, and this approach would not require a determination of a reasonable rate of return to the QF, which appears to be the conferees' primary concern.

Where a utility is a member of a centrally dispatched pool, the pool's marginal running cost will probably be the appropriate measure of the ceiling for energy rates. Simi-

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[11] The Conference Report states that a utility shall not be required to purchase energy from a QF at a rate which exceeds the lower of (1) the rate that is just and reasonable to the utility's customers and nondiscriminatory as to the QF and (2) the incremental cost of alternate electric energy. As stated above, we think that so long as the service being offered by a QF is fully comparable to the alternative, the payment to the cogenerator of the full cost of the alternative would be just and reasonable to the utility's customers. Thus we have difficulty in describing some particular price other than the avoided cost as being just and reasonable to the utility's customers; and difficulty in giving the Conference Report language cited above any precise meaning in a particular situation, other than that some price below the avoided cost is also just, reasonable, and permitted by statute. We do *not* understand the prescription that the proper price is the lower of the just and reasonable price and the avoided cost as requiring that the selling QF be restricted to a minimal mark-up from its marginal generation cost on its sales to a utility.

larly, if a pool has coordinated planning for capacity additions, the pool's method of sharing those costs should be considered, and in some instances utilized, in determining a pool member's avoided capacity costs.

As in the case of purchases by QFs, the rules for sales by QFs should permit sufficient latitude to allow "contractual pooling" among QFs to "firm up" capacity available to utilities. Such pooling could permit such things as coordinated scheduling for maintenance which would increase the assured availability of capacity to the utility. Although this may assure increased generating capacity, further consideration should be given to the potential impact on transmission costs of such arrangements.

Section 210(b) also requires that the rates for the purchases by the electric utilities not discriminate against QFs. It is not clear whether the statute only bars discrimination against QFs as a class, or whether it would also bar discrimination among QFs. If the latter, this may create some practical problems in administration. Since the price to be paid for the purchases by the utility is dependent, in part, on the utility's avoided costs, and these costs will vary over time and with the number and magnitude of cogeneration arrangements previously entered into, the rates paid will probably have to differ from one arrangement to another depending on when they were entered into and what future costs are being avoided. Further, as with multiple simultaneous interchange transactions, some priority among QFs may have to be established to determine which is viewed as displacing the utility's highest cost alternative power. Some vintaging arrangement or consistent formulary approach to the computation of the costs avoided may be considered in the rule for the purpose of determining whether the rates discriminate among qualifying facilities.

Under certain circumstances it may be desirable to allow a cogenerator or small power producer to sell all its output to a utility and at the same time purchase all its needs from the utility. Specifically, where a utility needs additional capacity, and one of its customers can build and operate a new generator more cheaply than the utility can, it would be in everyone's interest for the QF to build the unit. How-

ever, if the utility's embedded cost-based rates even after it built the new plant are lower than the incremental cost of power from the new facility the QF would have built, then it would be in the QF's interest to let the utility build the plant and supply its needs. Put another way, if a QF were prohibited from buying from and selling to a utility simultaneously, it would be compelled to "buy" from itself at its marginal cost. Where this is lower than the utility's rate based on average embedded cost, then the QF would still build the facility, as it should in this situation; but where the utlity's rate is lower than the QF's marginal cost, the wise firm would allow the utility to build and operate the new plant, even though it cannot do so as cheaply as the QF. This problem only arises where a new facility is involved. We have no idea how often the costs would be such that the more costly plant would be built[12] but since the utility's customers would benefit whenever a QF builds a lower-cost plant than the utility can build, we tentatively recommend that this simultaneous buying and selling be permitted in connection with new facilities.[13]

With regard to existing facilities, however, the situation is exactly the reverse. Here, permitting a customer who has been providing part or all of its own power needs to sell to a utility at or near the utility's incremental cost and simultaneously buy back the same power at average embedded cost would drive up the costs of power to the utility's other customers without doing anything to encourage new cogeneration or desirable kinds of small power production. Thus we would recommend that the rule prohibit this practice.

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[12] Unfortunately, it is quite possible that the difference in the investment tax credits which may be available to, respectively, a utility and an owner of a QF will distort this cost comparison.

[13] Under the provisions of the Fuel Use Act of 1978, the sale of more than 50% of the output of a new installation would give the facility the status of an electric power plant. As a consequence, absent exemption on other grounds, a cogenerator could not use oil or gas as the basic generation fuel. However, the Fuel Use Act does not apply to installations consuming less than 100 million Btus per hour.

As indicated in the preceding section, the ratemaking aspects of the interconnection costs may be handled in a variety of ways. Depending upon the size and type of generating equipment a QF has, whether or not the QF wants to operate in parallel with the interconnected utility, and the extent to which the QF expects to sell to the utility, many different types of facilities and arrangements may be appropriate. In many situations, all the required facilities may not be placed on the QF's facilities or at the point of interconnection; rather, it may be necessary for the utility to install or modify equipment elsewhere on the system in order to protect its and QF's equipment and operations.

While we are of the view that the authority to order interconnections is inherent in the Commission's other powers under Section 210, we do not regard this as settling the question of who bears the attendant cost. As to this question, we think the proscription against compelling to the utility's customers to subsidize QFs is dispositive: the QF should pay the reasonable costs of the interconnection necessary and appropriate to its circumstances. By the same token, however, the comparable costs attending the purchase or supplying of the same electric energy from an alternative source should be taken into account in determining the price the utility should pay the QF for electricity.

The recovery of the utility's costs of interconnection can be accomplished in either of two ways: through a lump-sum hook-up charge, or through a credit (where the utility is buying from the QF) or surcharge (where the QF is buying from the utility) to the basic price. Where these facilities' costs are to be amortized over a period of years or volume of sales, it would seem reasonable to allow the utility to secure its investment in some manner where either the financial integrity of the QF or the duration of the arrangement are in question.

As this entire discussion of pricing and interconnection indicates, the variety of arrangements that might be made between QFs and utilities is enormous. Therefore, we would recommend that the Commission promulgate broad general rules in the nature of guidelines, leaving flexibility

for the States to experiment and accommodate local circumstances, and leaving room for the parties to negotiate the particular terms and conditions of their arrangements within the broad parameters of the Commission's rules. Under this approach, the States and the Commission would function more as arbitrators of disputes the parties can not resolve than as traditional regulators. This approach is, in our view, practically unavoidable with regard to the sales by QFs to utilities. On the other hand, as noted above, the sale from utilities to QFs is in most instances the type of transaction the States now regulate, and continuation of this regulation without substantial change is certainly a real option.

Finally, we must observe that the arbitration of disputes approach espoused above is not appropriate where a utility is participating in the ownership or even the operation of a QF. We would recommend that the specific terms of such arrangements be scrutinized by the States to ensure that the pricing or other provisions are not unduly discriminatory or beneficial.

Environmental Impact Statement

It appears to us that an environmental impact statement will not be necessary for Section 210 alone. We reach this preliminary conclusion on the basis that most of the effect of Section 210 flows from statutory mandates as to which the Commission has little or no discretion the requirement that utilities buy from and sell to QFs; the requirement that the Commission grant exemptions necessary to encourage QFs (through it is not authorized to grant exemptions from environmental laws or regulations); and the requirement that prices be set within certain guidelines. In other words, we do not think that the Commission's adoption of one set of rules rather than another on those matters as to which the Commission has discretion or flexibility would constitute a major Federal action significantly affecting the quality of the human environment.

There does exist some question in our minds, though, as to whether the Section 201 rules together with the Section 210 rules will establish the fuel use and fuel efficiency

standards for qualifying cogenerators and qualifying small power producers; and the Section 210 rules will describe with some greater specificity than does the statute the benefits of qualification. The environmental impact of this part of PURPA (whether or not the impact is significant) will be a product of the two rules acting together.

As stated elsewhere in this memorandum, we anticipate that the number, size, and kind of QFs that will develop will vary considerably from state to state and region to region. Similarly, the amount and kinds of utility fuel displaced by QFs will differ significantly around the country. As a consequence, the states would appear to be in a very good position to provide the information from which the Commission can determine whether the Section 201 and 210 rules would have a significant effect on the quality of the human environment and whether that effect will be beneficial or detrimental. Therefore, we recommend that the Commission promptly invite comment from the States in particular and the public in general on this matter so that, at the least, there will be a basis for an assessment of environmental impact.

End of Memorandum.

Written Comments

Interested persons are invited to submit written comments on this staff paper to the Office of the Secretary, Federal Energy Regulatory Commission, 825 North Capitol Street, N.E. Washington, D.C. 20426. Comments should reference Docket No. RM79-55 on the outside of the envelope and on all documents submitted to the Commission.

Fifteen (15) copies should be submitted. All comments and related information received by the Commission by August 1, 1979, will be considered prior to the promulgation of final regulations.

By the Commission.

KENNETH F. PLUMB,
Secretary.

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UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

[18 CFR Part 292]

Docket No. RM79-55

SMALL POWER PRODUCTION AND COGENERATION FACILITIES—RATES AND EXEMPTIONS

NOTICE OF PROPOSED RULEMAKING REGARDING THE IMPLEMENTATION OF SECTION 210 OF THE PUBLIC UTILITIES REGULTORY POLICIES ACT OF 1978

(Issued October 18, 1979)

Section 210(a) of the Public Utility Regulatory Policies Act of 1978 (PURPA) requires that the Commission prescribe rules as it determines necessary to encourage cogeneration and small power production, requiring electric utilities to offer to:

(1) sell electric energy to qualifying cogeneration facilities and qualifying small power production facilities, and

(2) purchase electric energy from such facilities.

In addition, section 210(e) of PURPA requires the Commission to prescribe rules under which qualifying cogeneration and small power production facilities are exempted, in whole or in part, from the Federal Power Act, from the Public Utility Holding Company Act of 1935, and from State laws and regulations respecting the rates or respecting the financial or organizational regulation of electric utilities, if the Commission determines such exemption is necessary to encourage cogeneration and small power production.

On June 26, 1979, in Docket No. RM79-54, the Commission issued proposed rules regarding the determination of which cogeneration and small power production facilities are qualifying cogenration facilities or qualifying small power production facilities. Such qualifying facilities are entitled to avail themselves of exemptions set forth in section 210 of PURPA, and are eligible for exemption from the in-

cremental pricing provisions of section 206(c) of the Natural Gas Policy Act of 1978 (Order No. 49, § 282.203(e), issued September 28, 1979, 44 F.R. 57726).

On June 27, 1979, in Docket No. RM79-55, the Commission issued a Staff discussion paper regarding issues arising under section 210 of PURPA.[1] The Staff discussion paper set forth many legal and policy questions arising under section 210 of PURPA. In addition to those issues, comments received in response to the Staff discussion paper and in the public hearings held in San Francisco, Chicago, and Washington, D.C. in July, 1979 on this topic raised new questions regarding the Commission's responsibility to exercise its authority under section 210. The Commission has taken into consideration these questions and comments in developing this proposed rulemaking.

SUMMARY

The proposed rules provide that electric utilities must purchase electric energy and capacity made available by qualifying cogenerators and small power producers at a rate reflecting the cost that the purchasing utility can avoid as a result of obtaining energy and capacity from these sources, rather than generating an equivalent amount of energy itself or purchasing the energy from other suppliers. To enable potential cogenerators and small power producers to be able to estimate these avoided costs, the rules require electric utilities to furnish data with regard to present and future costs of energy and capacity on their systems.

These rules also provide that electric utilities must furnish electric energy to qualifying facilities on a nondiscriminatory basis, at a rate that is just and reasonable and in the public interest, and must provide certain types of serv-

[1] The Staff discussion paper in Docket No. RM79-55 concerned subjects also addressed in this proposed rulemaking. Since interested persons may submit comments in response to this rulemaking, the deadline for the filing of comments on the Staff discussion paper was not extended beyond the original deadline of August 1, 1979.

ice which may be requested by qualifying facilities to supplement or back up those facilities' own generation.

The rule exempts all qualifying cogeneration facilities and certain qualifying small power production facilities from rate and certain other regulations under the Federal Power Act, from the provisions of the Public Utility Holding Company Act of 1935 related to electric utilities, and from State laws regulating electric utility rates and financial organization.

The implementation of these rules is reserved to the State regulatory authorities and nonregulated electric electric utilities. Within one year of the issuance of the Commission's rules, each State regulatory authority or nonregulated utility must implement these rules. That implementation may be accomplished by the issuance of regulations, on a case-by-case basis, or any other means reasonably designed to give effect to the Commission's rules.

The Commission observes that this rulemaking represents an effort to evolve concepts in a newly developing area within rigid statutory constraints. The Commission is attempting to afford broad discretion to the State regulatory authorities and nonregulated electric utilities in recognition of the variety of institutional, economic, and local circumstances which may be affected by this proposed rulemaking. In this regard, the Commission seeks the fullest range of comments on the legal authority of proposed Commission action, and on the technical and practical aspects of the proposals set forth in this rulemaking.

SECTION-BY-SECTION ANALYSIS

SUBPART A—*Arrangements Between Electric Utilities and Qualifying Cogeneration and Small Power Production Facilities under Section 210 of the Public Utilities Regulatory Policies Act of 1978.*

§ 292.101 *Scope.*

Section 292.101(a) describes the scope of Subpart A of Part 292 of the Commission's rules. Subpart A applies to sales and purchases of electric energy and capacity between qualifying cogeneration and small power production facilities and electric utilities, and actions related to such sales

and purchases. Section 292.101(b) provides that the authority of this subpart does not preclude negotiated agreements between qualifying cogenerators or small power producers and electric utilities which differ from rates or terms which would otherwise be required under this subpart. Paragraph (b)(1) reflects the Commission's view that the rate provisions of section 210 of PURPA apply only if a qualifying cogenerator or small power producer chooses to avail itself of the rights and protections set forth in that section. An agreement between an electric utility and a qualifying cogenerator or small power producer to conduct sales or purchases at rates higher or lower, or under terms or conditions different from those set forth in these rules, does not violate the Commission's rules under section 210 of PURPA. Nor would provisions of State law or regulations which provide different incentives for small power production and cogeneration (than are provided in the Commission's rules) be preempted. The Commission recognizes that the ability of a qualifying cogenerator or small power producer to negotiate with an electric utility is buttressed by the existence of the statutory rights and protections of these rules, and the right of State regulatory agencies and nonregulated electric utilities to provide further encouragement fo these technologies.

If, prior to the existence of the rights and protections set forth in PURPA, a cogenerator or small power producer entered into a contractual agreement by which he received sufficient financial incentive to sell his electric output to a utility, the encouragement of cogeneration or small power production does not require that he be given additional incentives. Accordingly, paragraph (b)(2) provides that Subpart A will not affect the validity of any contract between a qualifying cogenerator of small power production facility and an electric utility. At the expiration of the contract, a cogenerator or small power producer will be able to avail himself of these rules.

§ 292.102 *Definitions.*

This section contains definitions applicable to Subpart A.

Paragraph (a) provides that terms defined in PURPA have the same meaning as they have in PURPA, unless further defined in this part of the Commission's regulations.

Subparagraph (1) defines a qualifying facility as a cogeneration or small power production facility which is a qualifying facility under § 292.208 of the Commission's regulations. Those regulations implement section 201 of PURPA, and are the subject of Docket No. RM79-54.

Subparagraph (2) defines "purchase" as the purchase of electric energy or capacity from a qualifying facility by an electric utility.

Subparagraph (3) defines "sale" as the sale of electric energy or capacity by an electric utility to a qualifying facility.

Subparagraph (4) defines "system emergency" as a condition on a utility's system which is likely to result in disruption of service to a significant number of customers or is likely to endanger life or property.

Subparagraph (5) defines "rate" as any price, rate charge, or classification made, demanded, observed, or received with respect to the sale or purchase of electric energy or capacity, or any rule, regulation, or practice respecting any such rate, charge, or classification, and any contract pertaining to the sale or purchase of electric energy or capacity.

Subparagraph (6) defines "avoided costs" as the costs to an electric utility of energy or capacity or both which, but for the purchase from a qualifying facility, the electric utility would generate or construct itself or purchase from another source. This definition is derived from the concept of "the incremental cost to the electric utility of alternative electric energy" set forth in section 210(d) of PURPA. It includes both the fixed and the running costs on an electric utility system which can be avoided by obtaining energy or capacity from qualifying facilities.

The costs which an electric utility can avoid by making such purchases generally can be classified as "energy" costs or "capacity" costs. Energy costs are the variable costs associated with the production of electric energy (kilowatthours). They represent the cost of fuel, and some operating

and maintenance expenses. If, by purchasing electric energy from a qualifying facility, a utility can reduce its energy costs or can avoid purchasing energy from another utility, the rate for a purchase from a qualifying facility is to be based on those energy costs which the utility can thereby avoid.

Capacity costs are the costs associated with providing the capability to deliver energy; they consist primarily of the capital costs of facilities. If a qualifying facility offers energy of sufficient reliability and with sufficient legally enforceable guarantees of deliverability to permit the purchasing electric utility to avoid the need to construct a generating unit, to enable it to build a smaller, less expensive plant, or to purchase less firm power from another utility, then the rates for such a purchase will be based on the net avoided capacity and energy costs.[2]

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[2] "Net avoided costs" are the excess of the total costs of the system developed in accordance with the utility's optimum capacity expansion plan, excluding the qualifying facility, over the system's total costs (before payment to the qualifying facility) developed in accordance with the utility's optimum capacity expansion plan including the qualifying facility. This concept recognizes that the energy cost associated with a deferred or avoided unit may be different from the energy costs of the qualifying facility which permitted that deferral or avoidance. In determining an optimum capacity expansion plan, a utility must consider both capacity and energy costs in order to minimize the anticipated total system costs. In providing for payments for avoided capacity, the Commission uses the term "net avoided cost" in recognition of the fact that various types of capacity will not produce the same amount of energy, so that some change in the dispatch of generation may be necessary from the remaining plants after a planned unit is deferred and the qualifying facility's capacity is substituted along with other available capacity to produce the same amount of energy at the minimum cost. This is particularly true, for example, where the capacity factor for the qualifying facility is less than the planned capacity factor from a base load (high capacity cost—low energy cost) alternative facility which is deferred. In such a case, although adequate capacity may exist on the system due to the purchase from the qualifying facility in lieu of the deferred base load unit, additional energy costs may be incurred due to increased generation from intermediate plants to make up the difference between the planned generation from the base load plant and the lesser total energy produced by the qualifying facility. Such increased energy cost is appropriately recognized by providing

There is considerable language in both the statute and the Conference Report, as well as the Federal Power Act, in support of the proposition that capacity payments are not only legally permitted to be required by the Commission, but also, at least in some circumstances, mandated.

The Conference Report addresses the calculation of the alternative cost standard at some length. The final paragraph of this section of the Report is the following:

> The conferees expect that the Commission, in judging whether the electric power supplied by the cogenerator or small power producer will replace future power which the utility would otherwise have to generate itself either through existing capacity or additions to capacity or purchase from other sources, will take into account the reliability of the power supplied by the cogenerator or small power producer by reason of any legally enforceable obligation of such cogenerator or small power producer to supply firm power to the utility.[3]

The references to "additions to capacity" and to obligations "to supply firm power" (the rates for which, in this Commission's experience, always include a capacity component) lead the Commission to the conclusion that, under Section 210, capacity payments to qualifying facilities can be required under certain circumstances; and that a utility's refusal to make payments based in part on avoided capacity payments could be discriminatory.

In addition, the Commission notes that the statutory language used in the Federal Power Act uses the term "electric energy" to describe the rates for sales for resale in interstate commerce. Demand or capacity rates are a traditional part of such rates. The term "electric energy" is used throughout the Act to refer both to electric energy and capacity. The Commission does not find any evidence that the term "electric energy" in section 210 of PURPA was in-

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for the payment to the qualifying facility of the *net* avoided costs. In this way, the ratepayers are assured of paying no more than the total costs that would have been incurred had the unit not been deferred.

[3] Conference Report on H.R. 4018, Public Utilities Regulatory Policies Act of 1978, H. Rep. No. 1750, 99, 95th Cong., 2d Sess. (1978)

tended to refer only to fuel and operating and maintenance expenses, instead of all of the costs associated with the provision of electric service.

To interpret this phrase to include only the energy would lead to the conclusion that the rates for sales to qualifying facilities only include the energy component of the rate. It is the Commission's belief that this was not the intended result, and thus provides an additional reason to interpret the phrase electric energy to include both energy and capacity.

§ 292.103 *Availability of Electric Utility System Cost Data.*

In order to be able to evaluate the financial viability of a cogeneration or small power production facility, an investor needs to be able to ascertain, before construction of a facility, the expected return on a potential investment. This return will be determined in part by the price at which the qualifying facility can sell its electric output. Under § 292.105 of these rules, the rate at which a utility must purchase that output is based on the utility's avoided costs.

In order to provide data to qualifying facilities which will assist them in determining the utility's avoided costs, § 292.103(b) of the rules requires electric utilities to make available to cogenerators and small power producers data concerning the present and anticipated future costs of energy and capacity on the utility's system. The data required to be provided to determine these avoided costs will have been prepared in compliance with the Commission's rules implementing section 133 of PURPA.[4] This section will thus, for the most part, require a table presenting data already developed.

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[4] For example, § 290.303(h) of the Commission's rules implementing section 133 of PURPA requires such electric utilities to report marginal energy costs for each month of the reporting period and for each month of the next five years. Section 290.302(g) of these rules requires electric utilities to report the estimated cost, in dollars per kilowatt of generation, of generation units likely to be installed to meet increases in peak demand. Section 290.302(f) requires the reporting of estimates, for the next ten years of information regarding total system capacity, and capacity to be supplied by other utilities.

Section 133 of PURPA applies to each electric utility whose total sales of electric energy for purposes other than resale exceeded 500 million kWh during any calendar year beginning after December 31, 1975, and before the immediately preceding calendar year. (The phrase "before the immediately preceding calendar year" refers to the year two years prior to the current year. For example, if an electric utility exceeded the 500 million kWh limit both during 1976 and 1979, it must comply with section 133 requirements in 1981.) Section 290.102(d) of the Commission's rules implementing section 133 of PURPA granted an extension until June 30, 1982,[5] to electric utilities covered by that section having total sales of energy for purposes other than resale of less than 1 billion kWh in each of the calendar years 1976, 1977, and 1978.

The proposed coverage under paragraph (a) of these regulations is the same as that provided pursuant to section 133 of PURPA and the Commission's rules implementing that section, with an exception provided in paragraph (c) as will be discussed.

Paragraph (b) provides that each regulated electric utility must furnish to the State regulatory authority, and maintain for public inspection, data related to the costs of energy and capacity of the electric utility's system. Each nonregulated electric utility must maintain such data for public inspection.

Subparagraph (1) requires each electric utility to provide the estimated avoided cost of energy on its system for various levels of purchases from qualifying facilities. The levels of purchases are to be stated in blocks of one hundred megawatts or less for systems with peak demand of 1000 megawatts or more, and in blocks equivalent to not more than ten percent of system peak demand for systems less than 1000 megawatts. This information is to be stated

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[5] Docket No. RM79-6, issued June 5, 1979, granted an extension until May 31, 1982, to electric utilities having total sales of electric energy for purposes other than resale of less than 1 billion kilowatt-hours in each of the calendar years 1976, 1977, and 1978. The Commission recently issued revised regulations in this docket which extended this date to June 30, 1982.

on a cents per kilowatt-hour basis, for daily and seasonal peak and off-peak periods, for the immediately preceding year, and on an estimated cents per kWh basis for the current calendar year and for each of the next five years.

Subparagraph (2) requires each electric utility to provide its schedule for the addition of capacity, planned purchases of firm energy and capacity, and planned capacity retirements for each of the next 10 years.

Subparagraph (3) requires each electric utility to provide the estimated costs at completion, on the basis of dollars per kilowatt, of planned capacity additions, including planned firm purchases.

Qualifying facilities may wish to sell energy or capacity to electric utilities which are not subject to the reporting requirements of paragraph (b). In that event, paragraph (c) provides that, upon request of a qualifying facility, an electric utility not otherwise covered by paragraph (b) must provide sufficient data to enable the cogenerator or small power producer to determine the utility's avoided costs. If such utility refuses to supply the requested data, the qualifying facility may apply to this Commission for an order requiring that the information be supplied. The Commission, in considering such applications, will take into account the burden on the facility.

A non-generating electric utility which does not own or plan to acquire generating capacity may incorporate the data provided by each of its supplying utilities in its compliance with the provisions of this section.

§ 292.104 *Electric Utility Obligations Under This Subpart.*

Section 210(a) of PURPA provides that the Commission shall prescribe rules requiring electric utilities to offer to purchase electric energy from qualifying facilities. The Commission interprets this provision to impose on electric utilities an obligation to purchase all electric energy and capacity made available from qualifying facilities, except during periods prescribed in § 202.105(e) and during system emergencies.

There are several circumstances in which a qualifying facility might desire that the electric utility with which it is

interconnected not be the purchaser of the qualifying facility's energy and capacity, but would prefer instead that an electric utility with which the purchasing utility is interconnected make such a purchase. If, for example, the purchasing utility is a non-generating facility, its avoided costs will be the price of bulk purchased power ordinarily based on an average figure representing the average cost of energy and capacity on the supplying utility's system. As a result, the rate to the qualifying facility would be based on those average costs. If, however, the qualifying facility's output were purchased by the supplying utility, its output could replace energy supplied by specific peaking units, and its capacity might enable the supplying utility to avoid the addition of new capacity. The costs, and thus the avoided costs, of peaking energy and new capacity are generally greater than system average figures.

Under these proposed rules, certain small electric utilities are not required to provide system cost data, except upon request of a qualifying facility. If, with the consent of the qualifying facility, a small electric utility chooses to transmit energy from the qualifying facility to a second electric utility, the small utility can avoid the otherwise applicable requirements that it provide the system cost data for the qualifying facility and that it purchase the energy itself.

Accordingly, paragraph (d) provides that a utility which receives energy or capacity from a qualifying facility may, with the consent of the qualifying facility, transmit such energy to another electric utility. However, if the first utility does not transmit the purchased energy or capacity, it retains the purchase obligation. Any electric utility to which such energy or capacity is delivered must purchase this energy under the obligations set forth in these rules as if the purchase were made directly from the qualifying facility.[6]

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[6] The Commission notes that while a purchase from a qualifying facility may have value as energy and capacity, what is actually transmitted to the second utility is properly described as electric energy. The utility to which energy is transmitted, however, must pay rates based on energy and capacity value.

The costs of transmission are not a part of the rate which an electric utility to which energy is transmitted is obligated to pay the qualifying facility. These costs are part of the costs of interconnection, and are the responsibility of the qualifying facility under § 292.108 of these rules. However, pursuant to agreement between the qualifying facility and any electric utility which transmits electric energy on behalf of the qualifying facility, the transmitting utility may share the costs of transmission. The electric utility to which the electric energy is transmitted has the obligation to purchase the energy at a rate which reflects the costs that it can avoid as a result of making such a purchase.

Paragraph (b) sets forth the statutory requirement of section 210(a) of PURPA that electric utilities offer to sell electric energy to qualifying facilities. This section creates a Federal right for qualifying facilities to obtain electric service, in addition to any service the electric utility is obligated to provide under State laws.

The State discussion paper dealt with the issue of whether there is inherent in section 210 of PURPA the authority to order interconnections between electric utilities and qualifying facilities, or whether qualifying facilities must use the procedures set forth in the new sections 210 and 212 of the Federal Power Act to gain interconnection.[7] The Commission believes that the requirement to interconnect is within the legal authority to the Commission under section 210 of PURPA, particularly subsumed within the requirement to buy and sell. To hold otherwise would mean that Congress intended to have qualifying facilities go through an extended and expensive proceeding simply to gain interconnection, contrary to the entire thrust of sections 201 and 210 of PURPA.

These sections evince the clear Congressional intent to encourage development of these desirable forms of generation, and to have the commercial development of these facilities proceed expeditiously. In other words, Congress has already made the judgment that these kinds of facilities serve one of the purposes of the Act as set out in section

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[7] Staff discussion paper, *supra*., at 10-14.

101, *viz*, "the optimization of the efficiency of use of facilities and resources by electric utilities", and it would be both redundant and unduly burdensome to have the sponsors of individual facilities show in an evidentiary hearing conducted under section 210 of the Federal Power Act that their project in particular would serve this end (or one of the other related goals established as criteria for an interconnection order in section 210(c)(2)). The purpose of an interconnection application, whether under section 202 or 210 of the FPA, is to secure service, whether emergency or otherwise; and section 210 of PURPA establishes the entitlement of a qualifying facility to service from the interconnected utility. In effect, the proponents of the view that a qualifying facility must apply under sections 210 and 212 of the FPA have the burden of showing that Congress intended inerconnection and the entitlement to buy and sell be denied to a qualifying facility which is unable to make the showings required by those sections, especially in light of the fact that a previously interconnected customer installing qualifying facilities would not have to so apply.

This is not to say that all of the protections that Congress has given the target of an interconnection application in sections 210 and 212 of the FPA are necessarily absent from section 210 of PURPA. The Conference Report on section 210 states that customers of utilities are not to be compelled to subsidize qualifying facilities, and this principle would seem to bear on the question of who pays the costs of interconnection as well as on the pre-unit price to be paid for energy. On the other hand, the Conference Report includes a proscription against "unreasonable rate structure impediments, such as unreasonable hook up charges." This provides another argument in favor of reading section 210 of PURPA as including interconnection authority, since the elaborate cost determination required under sections 210 or 212 of the FPA is redundant if the costs of interconnection are viewed simply as a feature of the rate structure with the charge therefor based on the cost of the utility. However, the Commission does view section 210 of the FPA as an alternate avenue for remedy available to any qualifying facility which wishes to apply under it.

The obligation to interconnect can be part of either an electric utility's option to purchase from or sell to a qualifying facility. With regard to the obligation to sell, State law ordinarily sets out the obligation of an electric utility to provide service to customers located within its service area. The Commission believes that State law will normally impose on an electric utility the obligation to interconnect and that the Commission's proposal will not, in most instances, impose any additional obligation on electric utilities.

As noted in the Staff discussion paper, by installing certain equipment, an electric utility can be protected from disruption of its operations caused by a qualifying facility. The Commission has not received comments which disagree with this understanding. Therefore, through the allocation of the costs associated with such equipment to the qualifying facilities, as provided in § 292.109, and through the imposition of standards for operating reliability under § 292.110, appropriate physical and financial protection for the electric utilities is provided in the Commission's proposed rules.

Several commentators urged that the Commission require electric utilities to offer to operate in parallel with a qualifying facility. By operating in parallel, a qualifying facility is enabled automatically to export any electric energy which is not consumed by its own load. Therefore, provided that the qualifying facility complies with the standards set forth in § 292.110 regarding operating reliability, the Commission proposes in paragraph (e) that electric utilities be required to offer to operate in parallel with a qualifying facility.

§ 292.105 *Rates for Purchases*

Section 210(b) of PURPA provides that in requiring any electric utility to purchase electric energy from a qualifying facility, the Commission must insure that the rates for such purchases be just and reasonable to the electric consumers of the purchasing utility, in the public interest, nondiscriminatory to qualifying facilities, and that they not exceed the

incremental costs of alternative electric energy (the costs of energy, which, but for the purchase, the utility would generate from another source).

Types of Purchases

In implementing this statutory standard, it is helpful to review industry practice respecting sales between utilities. Sales of electric power are ordinarily classified as either firm sales, where the seller provides power at the customer's request, or non-firm power sales, where the seller and not the buyer makes the decision whether or not power is to be available. Rates for firm power purchases include payments for the cost of fuel and operating expenses, and also for the fixed costs associated with the construction of generating units needed to provide power at the purchaser's discretion. The degree of certainty of deliverability required to constitute "firm power" can ordinarily be obtained only if a utility has several generating units and adequate reserve capacity. The capacity payment, or demand charge, will reflect the cost of the utility's generating units and the associated costs of assuring that firm power will be available on demand.

In contrast, the ability to provide electric power at the selling utility's discretion imposes no requirement for the construction of capacity on the seller. In order to provide power to customers at the seller's discretion, the selling utility needs only to provide for the cost of operating its generating units. These costs, called "energy" costs, ordinarily are the ones associated with non-firm sales of power.

Purchases of power from qualifying facilities will fall somewhere on the continuum between these two types of electric service. Thus, for example, wind machines that furnish power only when wind velocity exceeds twelve miles per hour may be so uncertain in availability of output as only to permit a utility to avoid generating an equivalent amount of energy. The utility must continue to provide capacity that is available to meet the needs of its customers. Rates for such sporadic purchases should thus be based on utility system's avoided incremental cost of energy (system lambda), and not based on avoided capacity.

On the other hand, photovoltaic cells, although subject to some uncertainty in power output, have the general advantage of providing their maximum power coincident with the system peak when used on a summer peaking system. The value of such power is greater to the utility than power delivered during off-peak periods. Since the need for capacity is based on system peaks, the qualifying facility's coincidence with the system peak should be reflected in the allowance of some capacity value and an energy component that reflects the avoided energy costs at the time of the peak.

A facility burning municipal waste or biomass can operate more predictably and reliably than solar or wind systems. It can schedule its outages during times when demand on the utility's system is low. If such a unit demonstrates a degree of reliability that would permit the utility to defer or avoid construction of a generating unit or the purchase or firm power from another utility, then the rate for such a purchase should be based on the avoidance of both energy and the capacity costs.

In order to be able to defer or cancel the construction of new generating units, a utility must obtain a commitment, sufficiently ahead of the lead time for the construction of its own new capacity, that provides contractual or other legally enforceable assurances that capacity from alternative sources will be available. If a qualifying facility makes such a commitment, the Commission believes that, as a matter of both policy and interpretation of section 210, the qualifying facility is entitled to receive rates based on the utility's avoided costs resulting from the capacity of qualifying facility supplies. Moreover, if a cogenerator or small power producer were permitted to receive only the energy (fuel, and operating and maintenance) expenses which the purchasing utility can avoid—while the cogenerator or small power producer must himself invest in new, and often highly capital-intensive, machinery—these potential sources of energy may go undeveloped. In light of the Commission's statutory obligation to encourage cogeneration and small power production, the Commission believe that a proper interpretation of "the incremental costs of alternative electric

energy" requires that, when purchases of energy can substitute for intermediate, or base-load, the rate to the cogenerator or small power producer include the net avoided capacity and energy costs.

If a qualifying facility opts to receive rates based on avoided energy costs, such rates should reflect the energy costs of the electric utility's units which otherwise would have been operated. The Commission believes that there are a variety of acceptable ways to carry out this policy at the State level. The general concept here is that rates for purchases from the qualifying facility would be based on the highest energy cost unit then operating. The qualifying facility would continue to be dispatched until the cost of energy costs is lower than the price at which the qualifying facility wishes to sell.

The Commision neither expects nor requires that the determination of utilities' avoided costs will be so precise. By definition, these costs are based on estimates of costs which would be incurred if certain events were to take place. Electric rates are ordinarily calculated on the basis of averaging. So long as a rate for purchases reasonably accounts for the avoided costs, and does not fail to provide the required encouragement of cogeneration and small power production, it will be considered as implementing these rules.

Paragraph (a) therefore provides that the statutory requirements regarding rates for purchases of energy and capacity from a qualifying facility as satisfied if the rates reflects the avoided costs resulting from such a purchase as determined on the basis of the cost of energy and capacity set forth pursuant to § 292.103(b) or (c).

Method of Implementation

The Commission is required under section 210 of PURPA to prescribe rules requiring electric utilities to offer to sell electric energy to and purchase elecric energy from qualifying facilities. Paragraphs (b) and (c) of section 210 set forth the standards regarding the rate at which such purchases and sales shall be made. The implementation of Commission rules promulgating these standards is reserved

to the State regulatory authorities and nonregulated utilities,which are required under section 210(f) to implement the Commission's rules.

One major area of concern expressed in comments received from electric utilities, cogenerators and small power producers, and State regulatory authorities has been that the Commission's rules should state general principles sufficient to leave the states and non-regulated utilities flexibility.[8] The basis for this recommendation is the need for experimentation in a new technological area and in an area that is subject to a variety of State procedures, the diverse nature of cogeneration and small power production systems, and the differences in the costs of energy and capacity on individual electric systems. As a result, while we herein propose that, for example, capacity costs must be paid if a utility can actually avoid the construction or purchase of capacity, our rules will not dictate the method by which such a payment is to be determined. Rather the Commission proposes to leave the selection of a methodology to the States and nonregulated electric utilities, with the understanding that should a State or nonregulated utility not fulfill the intent and purposes of our rules and of section 210 of PURPA, the Commission and others have available the enforcement power set forth in section 210(h) of PURPA to assure compliance. Additionally, the Commission is authorized to revise these rules in the future to provide greater specificity to these rules if that is necessary.

Paragraph (b) requires electric utilities, on request of a qualifying facility, to promulgate a tariff or other method for establishing rates for purchases from qualifying facilities of ten kilowatts or less. In Docket No. RM79-54 the Commission proposed a minimum size limitation for qualifying facilities of ten kilowatts. However, comments received in response to that proposed rulemaking indicate that such a limitation could hamper the development of

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[8] Comments of American Electric Power, filed August 1, 1979, at 2-3; Comments of Electric Consumer Resource Council (ELCON), filed August 1, 1979, at 6; Comments of the National Association of Regulatory Utility Commissioners (NARUC), filed August 1, 1979, at 2-5.

auxiliary solar and wind power units. Without finally determining that question in this rulemaking, it appears to the Commission that the burden of interconnected operation on both utilities and qualifying facilies can be minimized if standard tariffs are used.

Some utilities already have such tariffs in effect. For units of ten kilowatts or less, it is likely that few changes in the utility's distribution system would be required. For example, an electric utility might offer to permit certain customers to reverse their electric meters, thus permitting consumption by the customer. While the Commission will deal more extensively with the matter of a size limtiation for qualifying facilities in its final rule in Docket No. RM79-54, the Commission solicits comment here on the merits of requiring utilities to promulgate tariffs for qualifying facilities of ten kilowatts or less.

Paragraph (c) concerns a problem arising in the implementation of the concept of avoided costs. At the time that a qualifying facility delivers electric energy to an electric utility, that utility can determine its system lambda and thus calculate the costs it can avoid by making the purchase. Subparagraph (1) therefore provides rates for purchases made on an "as available" basis may be based on the purchasing utility's avoided energy costs.

In order to establish certainty of future revenue, a qualifying facility might seek to obtain a contract from a utility providing that the utility will pay a certain price for energy from a qualifying facility, under specified terms and conditions. Indeed, a qualifying facility desiring to obtain capacity credit must provide the purchasing utility with assurances that such capacity will continue to be available.

In the case of future purchases pursuant to a legally enforceable obligation, the utility's avoided energy or capacity costs may be based on the costs of production facilities which are not built and for which the only available cost data are estimates. When the qualifying facility actually supplies electricity, the utility's avoided costs may deviate from these estimated figures. The Commission believes that these potential deviations are a normal result of risk allocation resulting from contractual commitments or other

legal obligations, and believes that they must be permitted if the Commission is to fulfill its mandate to encourage cogeneration and small power production. Accordingly, subparagraph (2) provides tha rates for such purchases may be based on future estimated utility costs of energy or capacity regardless of whether these estimated costs actually track the actual costs that are incurred.

Paragraph (d) sets forth factors on the basis of which the State regulatory authority or nonregulated utility should determine a utility's avoided costs. These principles relate both to the quality of power available from the qualifying facility and its ability to displace or replace energy and capacity on the utility's system.

Subparagraph (1) deals with the availability of capacity from a qualifying facility during system daily and seasonal peak periods. If a qualifying facility can provide energy to a utility during peak periods when the electric utility is running its most expensive generating units, this energy has a higher value to the utility than energy supplied durng off-peak periods during which only units with lower running costs are operating. Ideally, the rates for purchases would reflect the cost in the purchasing utility s system at the precise moment when such energy is supplied. The metering equipment that would be required to ascertain these times of delivery with the requisite specificity may be either unavailable or prohibitively expensive. To the extent that such metering equipment is available, however, the State or nonregulatory utility should take into account the time at which the purchase from a qualifying facility is made.

Clauses (i), (ii), (iii), (iv), and (v) deal with the reliability of a qualifing facility. When an electric utility provides power from its own generating units or from those of another electricity utility, it normally controls the production of such power from a central location. The ability to so control power production enhances a utility's ability to respond to changes in demand and thereby enhances the value of that

power to the utility. A qualifying facility may be able to enter into an arrangement with the utility which gives the utility the advantage of dispatching the facility.[9]

Clause (ii) refers to a qualifying facility's ability and willingness to provide power and energy during system emergencies. Section 292.109 of these proposed regulations concerns the provision of electric service during system emergencies. It provides that, to the extent that a qualifying facility is willing to forego its own use of energy during sytem emergencies and provide power to a utility's system, the rate for purchases from the qualifying facility should reflect the value of that service. Small power production and cogeneration facilities could provide significant back-up capability to electric systems during emergencies. One benefit of the encouragement of interconnected cogeneration and small power production may be to increase overall system reliability during such emergency conditions. Any such benefit should be reflected in the rate for purchases from such qualifying facilities.

Clause (iii) deals with periods during which a qualifying facility is unable to provide power. Electric utilities schedule maintenance outages for their own generating units at periods during which demand is low. If a qualifying facility can similarly schedule its maintenance outages during periods of low demand, or during periods in which a utility's capacity will be adequate to handle existing demand, it will enable the utility to avoid the necessity to provide redundant capacity. With regard to forced or unscheduled outages, addressed in clause (iv), it is clear that a utility cannot avoid the construction or purchase of capacity if it is likely that the qualifying facility which would replace such capacity may go out of service during the period when the utility needs its power to meet demand. Based on estimated and demonstrated reliability of the qualifying facility, the rate for purchases from a qualifying facility should be adjusted to reflect its forced and scheduled outage rate.

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[9] See comments of Hawaiian Electric Company, filed July 27, 1979, at 2.

Subclause (v) refers to the length of time during which the qualifying facility has contractually or otherwise guaranteed that it will supply energy or capacity to the electric utility. A utility-owned generating unit normally will supply power for the life of the plant, or until it is replaced by more efficient capacity. In contrast, a cogeneration or small power production unit might cease to produce power as a result of changes in the industry or in the industrial processes utilized. Accordingly, the value of service from the qualifying facility to the electric utility will be affected by the degree to which the qualifying facility contractually insures that it will continue to provide power. In order to provide capacity value to an electric utility a qualifying facility need not necessarily agree to provide power for the life of the plant. A utility's generation expansion plans normally include temporary purchases of firm power from other utilities in years preceeding the addition of a major generation unit. If a qualifying facility contracts to deliver power, for example, for a one year period, it may enable the purchasing utility to avoid entering into a bulk power purchase arrangement with another utility. The rate for such a purchase should thus be based on the price that such power is purchased, or can be expected to be purchased, based upon bona fide offers from another utility.

Subparagraph (2) concerns the relationship of energy or capacity from a qualifying facility to the purchasing electric utility's need for such energy or capacity. If an electric utility has sufficient capacity to meet its demands and is not planning to add any new capacity to its systems, then the availability of capacity from qualifying facilities will not immediately enable the utility to avoid any capacity costs.[10] This is not to say that electric utilities with systems which have excess capacity need not make purchases from qualifying facilities; qualifying facilities may obtain payment for the avoided energy costs on a purchasing utility's system. Utility systems with excess capacity normally have intermediate or peaking units which use fossil fuel. As a result,

[10] Such availability may, however, permit the utility to advance the retirement of its least effective units.

during peak hours the energy costs on the system are high, and thus the rate to a qualifying utility from which the electric utility purchases energy should similarly be high. In addition, an electric utility system with excess capacity may nevertheless plan to add new, more efficient capacity to its system. If purchases from qualifying facilities enable a utility to defer or avoid these new planned capacity additions the rate for such purchases should reflect the avoided costs of these additions.

Clause (i) of subparagraph (2) refers to the aggregate capability of capacity from qualifying facilities to displace existing or planned utility capacity. In some instances, the small amounts of capacity provided from qualifying facilities taken individually might not enable a purchasing utility to defer or avoid scheduled capacity additions or purchases. The aggregate capability of such purchases may, however, be sufficient to permit the deferral or avoidance of a capacity addition. Moreover, while an individual qualifying facility may not provide the equivalent of firm power to the electricity utility, the diversity of these facilities may collectively reflect the equivalent of firm power. The States and nonregulated utilities should attempt to devise rate mechanisms which will appropriately compensate qualifying facilities whose aggregate capacity enables the purchasing utility to defer or avoid capacity additions.

Clause (ii) refers to the fact that the lead time associated with the addition of capacity from qualifying facilities may be less than the lead time that would have been required if the purchasing utility had constructed its own generating unit. Such reduced lead time might produce savings in the utility's total power production cost.

Subparagraph (3) addresses the cost or savings resulting from line losses. In determining an appropriate rate for purchases from a qualifying facility the rate should reflect the cost savings actually accruing to the electric utility. If energy produced from a qualifying facility undergoes line losses such that the delivered power is not equivalent to the source of power it replaces, then the qualifying facility should be reimbursed only for the equivalent amount. If the load served by the qualifying facility is closer to the quali-

fying facility than it is to the utility, it is possible that there may be net savings resulting from reduced line losses. In such cases, the rates should be adjusted upwards.

Subparagraph (4) provides that an electric utility will not be required to purchase energy and capacity from qualifying facilities during periods in which such purchases might result in net increased operating costs to the electric utility. Identification of these periods will be made by the State regulatory authority which has jurisdiction over the utility or by the nonregulated electric utilities. Comments received in response to the Staff discussion paper noted that if, for example, during low load periods, a utility were operating a nuclear plant as its most expensive unit, and were forced to cut back output from such a unit in order to accommodate a purchase from a qualifying facility, the utility would experience increased costs in increasing the output from the nuclear facility when the system demand increases.[11]

Thus, because the avoided cost is zero or actually involves expense to the utility, requiring the utility to purchase energy from a qualifying facility during such a period would not be just and reasonable to the consumers of the electric utility, because it would result in increased costs to the system's rate payers. Under the propsoed § 292.104(a) an electric utility would not be required to make energy purchases during such a period.

Tax Issues

The Statement of the Committee of Conference states that

> ...the examination of the level of rates which should apply to the purchase by the utility of the cogenerator's or the small power producer's power should not be burdened by the same examination as are utility rate applications to determine what is the just and reasonable rate that they should receive for their electric power.

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[11] Comments of Commonwealth Edison Company, filed August ., 1979 at 4.

We note that section 301(b)(2) of the Energy Tax Act of 1978[12] made eligible for increased business investment tax credit certain property that may be used by small power producers or cognerators. However, section 301(b)(2)(B) excludes from such eligibility property "which is public utility property (within the meaning of section 46(f)(5) of the Internal Revenue Code of 1954)."[13] As a result, if a qualifying facility were to be classified as a public utility under section 46(f)(5) of the Internal Revenue Code, it would not be eligible for the increased investment tax credit otherwise available.

The Commission notes that a recent change[14] in Treasury Department regulations amended the definition of the exclusion "public utility property" for purposes of eligibility for the investment tax credit so as to exclude [from the definition] property used in the business of the furnishing or sale of electric energy if the rates are not subject to regulation that fixes a rate of return on investment. Prior to the change, any rate regulation made property subject thereto (and involved in the furnishing or sale of energy) public utility property.

The Commission observes that the rates for purchases set forth in this rulemaking for purchases of energy from qualifying facilities are *not* based on a rate of return on investment. As a result, the Commission believes that property owned by qualifying facilities should not be classified as public utility property under section 46(f)(5) of the Internal Revenue Code of 1954. If such property is not classified as public utility property, the qualifying facility will be eligible to receive the additional investment tax credit set out in section 301(b) of th Energy Tax Act of 1978. The Commission wishes to express its opinion on this matter in an effort to further encourage cogeneration and small power production by means of this rulemaking process.

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[12] Pub. L. No. 95-618, 26 U.S.C. §§ 46, 48, November 9, 1978.

[13] 26 U.S.C. § 48 (e)(3)(b).

[14] Treasury Reg. § 1.46-3(g)(2), T.D. 7602 (March 23, 1979).

§ 292.106 *Rates for Sales.*

Section 210(c) of PURPA provides that the rules requiring utilities to sell electric energy to qualifying facilities shall ensure that the rates for such sales are just and reasonable, in the public interest, and nondiscriminatory against qualifying cogenerators or small power producers. As noted in the Staff discussion paper,[15] this section contemplates rates formulated on the basis of traditional ratemaking (*i.e.*, costs of service) concepts.

Paragraph (a) provides that rates for sales from electric utilities to qualifying facilities shall not be discriminatory against such facilities in comparison to rates to other customers served by the electric utility. Paragraph (a) also states that such rates shall be just and reasonable and in the public interest.

The qualifying facility is entitled to purchase back-up or standby power at a rate which reflects the probability that the qualifying facility will or will not contribute to the need for utility capacity and the use of utility capacity.[16] Thus, when the utility must reserve capacity to provide service to a qualifying facility, the costs associated with that reservation are properly recoverable from the qualifying facility if the utility would assess these costs to non-generating customers.[17]

Paragraph (b) provides that electric utilities must provide to qualifying facilities any services which would be provided by the electric utility to a retail customer who does not have his own generation.

Normally the determination of an appropriate rate to a class of customers is based on an examination of load data relating to such customers. At this time, however, even those utilities which have good load data regarding existing customer classes do not have load data regarding usage by

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[15] Staff discussion paper, *supra*, at 14-20.

[16] Comments of ELCON (Electricity Consumer Resource Council), filed August 1, 1979, at 5.

[17] Comments of Consumers Power Company, filed August 1, 1979, at 3.

qualifying cogeneration and small power production facilities. Until such data is collected, the Commission believes that rates for sales to qualifying facilities should be at least as favorable as those available to utility customers having comparable load characteristics or falling under simmilar load classifications.

Paragraph (c) sets forth certain types of service which electric utilities are required to provide to qualifying facilities even if such types of service are not provided to other customers. These types of service are: supplementary power, back-up power, interruptible power, and maintenance power. The Commission believes that this requirement is necessary to encourage small power production and cogeneration.

Supplementary power is power used by a facility in addition to that which it ordinarily generates on its own. Thus, a cogeneration facility with a capacity of ten megawatts might require five more megawatts from a utility on a continuing basis to meet its electric load of fifteen megawatts. The five megawatts supplied by the electric utility would normally be provided as supplementary power.

Back-up power is power available to replace power generated by a facility's own generation equipment. In the example provided above, a cogeneration facility might contract with an electric utility for the utility to have available ten megawatts, should the cogenerator's units experience an outage.

Interruptible power is power supplied by a utility on an "as available" basis. Because interruptible power normally is sold at a lower rate, a qualifying facility may wish to cease operations when utility power is interrupted rather than pay the higher rate necessary to assure firm supplementary supplies.

Maintenance power is supplied during scheduled outages. By prearrangement, a utility can agree to provide such power during periods when the utility's other loads are low, thereby avoiding the imposition of large demands on the utility during peak periods.

Paragraphs (d)(1) and (d)(2) provide that rates for sales of back-up or maintenance power shall not be based on the

assumption that forced outages or other reductions in output by each qualifying facility on an electric utility's system will occur simultaneously or on the assumption that they will occur during the system peak. Like other customers, qualifying facilities have intraclass diversity. In addition, because of the variations in size and load requirements among various types of qualifying facilities, such facilities will have interclass diversity.

The effect of such diversity is that an electric utility supplying back-up or maintenance power to qualifying facilities will not have to plan for reserve capacity to serve such facilities on the assumption that every facility will use power at the same moment. The Commission believes that probabilistic analysis of their demand will show that a utility need not reserve capacity on a one-to-one basis to meet back-up requirements. Paragraphs (d)(1) and (d)(2) prohibit utilities from basing rates on the unsupported assumption that qualifying facilities will impose demands simultaneously and at system peak.

Paragraph (d)(3) provides that rates for sales from an electric utility to a qualifying facility shall take into account the extent to which a qualifying facility has coordinated periods of scheduled maintenance with an electric utility. If a qualifying facility coordinates periods of outage with an electric utility the demand that the qualifying facility imposes on the utility's system will not create capacity requirements to the same extent that such a demand would create if the utility were required to provide such service without prior notice.

§292.107 *Simultaneous Purchase and Sale.*

Section 292.107 deals with the situation referred to in the Staff discussion paper in which a cogenerator or small power producer desires to sell all of its output to a utility and purchase all of its needs from the utility simultaneously. As observed in the Staff discussion paper, an efficient use of society's resources requires that when there is a need for additional capacity, and a utility's customer can construct a new plant more cheaply than the utility can, he should be

encouraged to do so.[18] A qualifying facility may have previously used a portion of its electric output to supply its own power needs. That it chose to generate its own electric power, rather than purchase such power from an electric utility, indicates that there were sufficient economic incentives to so act. To permit such a facility to sell that portion of its electric output to the utility at the utility's avoided costs and replace that electricity from the electric utility at non-incremental (and presumably lower) rates would increase the purchased power costs of the purchasing utility and thus would increase the rates charged to the utility's other customers. The Commission believes that it is not necessary to the encouragement of cogeneration and small power production that a qualifying facility be permitted to obtain avoided cost-based rates for this portion of its electric output. Accordingly, the Commission proposes that for energy generated by a new facility or by capacity installed after the date of issuance of these rules, a qualifying facility be permitted to sell its output at rates established under the section 210(b) of PURPA pricing mechanism while simultaneously purchasing electric energy from a utility pursuant to its retail rate schedules.

§ 292.108 *Costs of Interconnection*

Paragraph (a) defines "interconnection costs" as the reasonable costs of connection, switching, metering, transmission, safety provisions and other costs to an electric utility resulting from interconnected operation between an electric utility and a qualifying facility.

Paragraph (b) states that each qualifying facility must reimburse any electric utility which purchases capacity or energy from the qualifying facility for any interconnection costs. These costs are limited to the net increased costs imposed on an electric utility compared to those it would have incurred had it generated the energy itself or purchased an equivalent amount of energy or capacity from another source.

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[18] Staff discussion paper, *supra* at 24-25.

If, with the consent of a qualifying facility, an electric utility elects to transmit energy from the qualifying facility to another electric utility, the costs of transmission constitute interconnection costs as defined in this paragraph. Under paragraph (b), these costs must be borne by the qualifying facility unless the transmitting utility agrees to share them.

The cost responsibility of the qualifying facility was well summarized in comments by The Southern Company:

> We believe that the interconnection costs which should be addressed in the rules are those incremental costs that go beyond the cost to the system for connecting a normal (i.e., no generation) customer. These costs will include the additional relaying, switching, metering, line, and protective equipment—inclusive of equipment changeout cost—required in the general vicinity of the facility because of the customer's generation. Recognition must be given to the fact that protection goes beyond the protection of equipment and personnel of the qualifying facility and utility. The rules also must provide for the protection of other customers of the utility that may be affected by the operation of the qualifying facility.[19]

Thus, it is only the additional costs which result from interconnected operation for which the qualifying facility is responsible; if the utility would have provided retail service to the customer, those expenses may not be assessed against the qualifying facility merely because the facility is also supplying power and energy. If, however, as a result of the qualifying facility's export of power, the utility is required to install additional switching, safety or other equipment, the qualifying facility is responsible for those expenses.

Paragraph (e) provides that a qualifying facility must reimburse an electric utility which sells capacity or energy to the qualifying facility for interconnection costs resulting from such sale. Ordinarily, the service obligation of an electric utility will contain standard procedures for the allocation of interconnection costs between a retail customer and

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[19] Comments of the Southern Company, filed July 30, 1979, at 5.

the electric utility. Paragraph (c) also provides that interconnection costs to qualifying facilities shall not be discriminatory in relation to the practices of the electric utility with regard to other retail customers.

§ 292.109. *System Emergencies.*

Paragraph (a) provides that, except as provided under section 202(c) of the Federal Power Act or pursuant to a contract or agreement between a qualifying facility and an electric utility, no qualifying facility shall be compelled to provide energy or capacity to the electric utility during an emergency beyond the extent provided by agreement between the qualifying facility and the utility.

Many comments from cogenerators and small power producers expressed concern that, during a system emergency, they might be required to make available all of their generation to the utility. Such a requirement might interrupt industrial processes with resulting damage to equipment and manufactured goods. Many industries install their own generating equipment in order to insure that even during a system emergency, their supply of power is not interrupted. To put in jeopardy the availability of power because of the facility's ability to provide power to the system during non-emergency periods would result in the discouragement of interconnected operation and a resultant discouragement of cogeneration and small power production. The Commission therefore proposes that the qualifying utility's obligation to provide power be established through contract.

In order to receive full credit for capacity, a qualifying facility must offer power during system emergencies to the same extent that it has agreed to provide power at the purchasing utility's discretion. For example, a 30 megawatt cogenerator may require 20 megawatts for its own industrial purposes, and thus may contract to provide 10 megawatts of capacity to the purchasing utility. During an emergency, the cognenerator must provide the 10 megawatts contracted for to the utility; it need not disrupt its industrial processes by supplying its full capability of 30 megawatts. Of course, if it should so desire, a cogenerator could

contractually agree to supply the full 30 megawatts during system emergencies. The availability of such additional back-up capacity should increase utility system reliability, and should be accounted for in the utility's rates for purchases from the cogenerator.

Paragraph (b) provides that an electric utility may discontinue purchases from a qualifying facility during a system emergency if such a purchase would contribute to the emergency. In addition, during system emergencies, a qualifying facility must be treated on a non-discriminatory basis—i.e., on the same basis that other customers of a similar class with similar load characteristics are treated with regard to interruption in service.

§ 292.110 *Standards for Operating Reliability*

Section 210(a) of PURPA states that the rules requiring electric utilities to buy from and sell to qualifying facilities shall include provisions respecting minimum reliability of qualifying facilities (including reliability of such facilities during emergencies) and rules respecting reliability of electric energy service to be available to such facilities from electric utilities during emergencies. Staff's analysis presented in the discussion paper regarding reliability of a particular qualifying facility concluded that every incidence of qualifying facility reliability can be accounted for through price; namely, the less reliable a qualifying facility might be, the less it should be entitled to receive for purchases of its power by the utility. The majority of comments received regarding this issue endorsed the Staff's recommendation. Accordingly, the Commission proposes that there be no specific standard relating to the reliability in the sense of ability to provide power for qualifying facilities.

Many commentors have proposed that the Commission's rules ensure that interconnection with qualifying facilities does not disrupt system reliability. One commentor proposed that qualifying facilities must automatically disconnect from utility lines upon interruption or interference with utility service, or upon the flow of excessive current between the utility system and the non-utility generator.[20]

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[20] Comments of Illinois Power Company, filed August 14, 1979.

It is the Commission's understanding that safety equipment exists which can ensure that qualifying facilities do not energize utility lines during utility outages. This section accordingly provides that any qualifying facility may be subject to reasonable standards to ensure system safety and reliability in interconnected operations. Each State regulatory authority and nonregulated electric utility is permitted to establish standards for interconnected operations between electric utilities and qualifying facilities. These standards may be recommended by a utility or any other person. The standards must be accompanied by a statement showing the need for the standard on the basis of system safety and operating requirements.

SUBPART C

Summary of this Subpart

Rules proposed in this subpart are intended to carry out the responsibility of the Commission to encourage cogeneration and small power production by clarifying to all parties concerned the nature of the obligation to implement the Commission's rules under section 210.

In the Commission's view, section 210(f) affords the State regulatory authorities and nonregulated electric utilities great latitude in determining the manner of implementation of the Commission's rules so long as the manner chosen is reasonably designed to implement the requirements of Subpart A. The Commission recognizes that many States and individual nonregulated electric utilities have ongoing programs to encourage small power production and cogeneration. The Commission also recognizes that economic and regulatory circumstances vary from State to State and utility to utility. It is within this broad latitude, and with the recognition of the work already begun and of the variety of local conditions that the Commission proposes to promulgate its regulations requiring implementation of rules issued under section 210.

Because of the Commission's desire not to create unnecessary burdens at the State level, these proposed rules provide a procedure whereby a State regulatory authority or nonregulated electric utility may apply for a waiver if it can

demonstrate that compliance with certain requirements of Subpart A is not necessary to encourage cogeneration or small power production and is not otherwise required under section 210.

Implementation

Section 210(f) of PURPA requires that within one year after the date that this Commission prescribes its rules under subsection (a), and within one year of the date any of these rules is revised, each State regulatory authority and each nonregulated electric utility, after notice and opportunity for hearing, must implement the rules or revisions thereof, as the case may be.

The obligation to implement section 210 rules is a continuing obligation which begins within one year after promulgation of such rules. The requirements to implement may be fulfilled either through (1) the enactment of laws or regulations at the State level, (2) by application on a case-by-case basis by the State regulatory authority, or nonregulated utility, of the rules adopted by the Commission, or (3) by any other action reasonably designed to implement the Commission's rules. In the first case, implementation would consist of the issuance of rules after notice, and an opportunity for a hearing. In the second case, the State regulatory authority or nonregulated utility would be required to hold hearings regarding its proposed procedure for operating on a case-by-case basis, within the one-year statutory period.

Review and Enforcement

Section 210(g) of PURPA provides one of the means of obtaining judicial review of a proceeding conducted by a State regulatory authority or nonregulated utility for purposes of implementing the Commission's rules under section 210. Under subsection (g), review may be obtained pursuant to procedures set forth in section 123 of PURPA. This section contains provisions with regard to judicial review and enforcement of determinations made by State regulatory authorities and nonregulated utilities under Subtitle A, B. or C of Title I in the appropriate State court. These provisions also apply to review of any action taken to

implement the rules under section 210. This means that persons can bring actions in State court to require the State regulatory authorities or nonregulated utilities to implement these regulations. Section 123(c)(2) of PURPA restates the requirements of section 123(c)(1) as they apply to Federal agencies. This distinction between Federal agencies and non-Federal agencies also applies to review and enforcement of the implementation of the rules under section 210.

Finally, the Commission believes that review and enforcement of implementation under section 210 of PURPA, can consist not only of review and enforcement as to whether the State regulatory authority or nonregulated electric utility has conducted the initial implementation properly—namely put into effect regulations implementing section 210 rules or procedures for that implementation, after notice and an opportunity for a hearing. It can also consist of review and enforcement with regard to the application by a State regulatory authority or nonregulated electric utility, on a case-by-case basis, of its regulations or any other provision it may have adopted to implement the Commission's rules under section 210.

Section 210(h)(2)(A) of PURPA states that the Commission may enforce regulations under section 210(f). The Congress has provided not only for private causes of action in State courts to obtain judicial review and enforcement of the implementation of the Commission's rules under section 210, but has also given to the Commission that authority.

SECTION-BY-SECTION ANALYSIS

§ 292.301—*Implementation by State Regulatory Authorities and Nonregulated Utilities*

Paragraph (a) of § 292.301 sets forth the obligation of each State regulatory authority to commence implementation of Subpart A within one year of the date these rules take effect. In complying with this paragraph the State regulatory authorities are required to provide for notice and opportunity for public hearing. As described in the summary of this part, such implementation may consist of the adoption of the Commission's rules, an undertaking to

resolve disputes between qualifying facilities and electric utilities arising under Subpart A, or any other action reasonably designed to implement Subpart A.

This section does not cover one provision of Subpart A which is not required to be implemented by the State regulatory authority or nonregulated electric utility. This provision is § 292.103, the implementation of which is subject to § 292.302, which will be discussed below.

Subsection (b) sets forth the obligation of each nonregulated electric utility to commence, after notice and opportunity for public hearing, implementation of Subpart A. The nonregulated electric utilities, being both the regulator and the utility subject to the regulation, may satisfy the obligation to commence implementation of Subpart A through issuance of regulations, an undertaking to comply with Subpart A, or any other action reasonably designed to implement that subpart. Paragraph (c) sets forth a reporting requirement under which each State regulatory authority and nonregulated electric utility is to file with the Commission not later than one year after these rules take effect, a report describing the manner in which it is proceeding to implement Subpart A.

§ 292.302—*Implementation of Reporting Objectives*

The obligation to comply with § 292.103 is imposed directly on electric utilities. This is different from the rest of Subpart A where the obligation to act is imposed on the State regulatory authority or nonregulated electric utility in its role as regulator. The Commission is exercising its authority under section 133 of PURPA to require this reporting.

Any electric utility which fails to comply with the requirements of § 292.103(b) is subject to the same penalties as it might receive as a result of a failure to comply with the requirements of the Commission's regulations issued under section 133 of PURPA. As stated earlier in this preamble, the data required by § 292.103 will form the basis for the rates for purchases; § 292.103 is thus a critical element in the program this Commission is providing. The Commission believes that, with regard to utilities subject

to section 133 of PURPA, the Commission may exercise its authority under section 133 to require the data required by § 292.102(b) on the basis that the Commission finds such information necessary to allow determination of the costs associated with providing electric services. With regard to utilities not subject to section 133, if they fail to provide the data called for in § 292.103(c), the Commission may compel its production under the Federal Power Act and other statutes which give the Commission authority to require reporting of this data.

§ 202.303—*Waivers*

Paragraph (a) provides for a procedure by which any State regulatory authority or nonregulated electric utility may apply for a waiver from the application of any of the requirements of Subpart A other than § 292.103. This provision is included in recognition of the need for the Commission to afford flexibility to the States and non-regulated utilities to implement the Commission's rules under section 210.

Paragraph (b) provides that any electric utility subject to the requirements of § 292.103(c) may apply to the Commission for a waiver from the application of such requirements. This provision is included to afford to the Commission flexibility to enforce the obligations of § 292.103(c) so that it may consider the burden which may be placed on the utility by application of this section.

SUBPART D—*Exemption of Qualifying Small Power Production and Cogeneration Facilities From Certain Federal and State Laws and Regulations*

§ 292.401—*Exemptions For Qualifying Facilities from the Federal Power Act.*

Section 210(e) of PURPA states that the Commission shall prescribe rules under which qualifying facilities are exempt in part from the Federal Power Act, from the Public Utility Holding Company Act of 1935, from State laws and regulations respecting the rates, or respecting the financial or organizational regulation, of electric utilities, or from any combination of the foregoing, if the Commission

determines such exemption is necessary to encourage cogeneration and small power production. As noted in the Staff discussion paper, the Congres sintended the Commission to make liberal use of its exemption authority in order to remove the disincentive of utility-type regulation. The Commission believes that broad exemption is appropriate.

Section 210(e)(2) of PURPA provides that the Commission is not authorized to exempt small power production facilities of 30 to 80 megawatt capacity from any of these laws. An exception is made for small power production facilities using biomass. Such facilities between 30 and 80 megawatts may be exempted from the Public Utility Holding Company Act of 1935 and from State regulations but may not be exempted from the Federal Power Act.

Paragraph (a) sets forth those facilities eligible for exemption. Paragraph (b) provides that facilities described in paragraph (a) shall be exempted from all but certain specified sections of the Federal Power Act.

Section 210(e)(3)(C) of PURPA provides that no qualifying facility may be exempted from any license or permit requirement under Part I of the Federal Power Act. Accordingly, the Commission proposes not to exempt qualifying facilities from Part I of the Federal Power Act. The Commission recently issued simplified procedures for obtaining water power licenses for hydroelectric projects of 1.5 megawatts or less, and has issued proposed regulations to expedite licensing of existing facilities.[21]

As noted in the discussion paper, cogenerators and small power production facilities could be the subject of an order under section 202(c) of the Federal Power Act requiring them to provide energy if the Economic Regulatory Administration determines that an emergency situation exists. Because application of this section is limited to emergency situations and is not affected by the fact that a facility attains qualifying status or engages in interchanges with an

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[21] *See* Order No. 11, Simplified Procedures for Certain Water Power Licenses, Docket No. RM79-9, issued September 5, 1978, and Application for License for Major Project—Existing Dam, Docket No. RM79-36, 44 F.R. 24095 (April 21, 1979).

electric utility, the Commission proposes that qualifying facilities not be exempted from section 202(c) of the Act.

Sections 203, 204, 205, 206, 208, 301, 302 and 304 of the Act reflect traditional rate regulation or regulation of securities of public utilities. The Commission proposes that qualifying facilities be exempted from these sections of the Federal Power Act.

Section 305(c) of the Act imposes certain reporting requirements on interlocking directorates. The Commission proposes that any person who otherwise is required to file a report regarding interlocking positions not be exempted from such requirement because he or she is also a director or officer of a qualifying facility.

Finally, the enforcement provisions of Part III will continue to apply with respect to the sections of the Federal Power Act from which qualifying facilities are not exempt.

§ 292.402—*Exemptions for Qualifying Facilities from the Public Utility Holding Company Act and Certain State Laws and Regulations.*

Under section 210(e) of PURPA the Commission can exempt qualifying facilities from regulation under the Public Utility Holding Company Act of 1935 and State laws and regulations concerning rates or financial organizations. Only cogeneration facilities and small power production facilities of 30 megawatts or less may be exempted from both of these laws, with the exception that any qualifying small power production facility (i.e., up to 80 megawatts) using biomass as a primary energy source can be exempted from these laws.

The Staff discussion paper recommended that, where a qualifying facility is subjected to more stringent regulation than other companies solely by reason of the fact that it is engaged in the production of electric energy, these more stringent requirements should be eased through exemption of qualifying facilities. By excluding any qualifying facility from the definition of an "electric utility company" under section 79 (b)(3) of the Public Utility Holding Company Act of 1935, such facilities would be removed from Public Utility Holding Company Act regulation which is applied exclu-

sively to electric utility companies. Moreover, by excluding qualifying facilities from this definition, parent companies of qualifying facilities would not be subject to additional regulation as a result of electric activities of their subsidiaries. The Commission therefore believes that in order to encourage cogeneration and small power production it is necessary to exempt cogenerators and small power producers from the provisions of the Public Utility Holding Company Act of 1935.

Accordingly, paragraph (b) states that no qualifying facility shall be considered to be an "electric utility company", as defined in section 79 (b)(3) of the Public Utility Holding Company Act of 1935.

Section 210(e) of PURPA states that qualifying facilities which may be exempted from the Public Utility Holding Company Act may also be exempted from State laws and regulations respecting the rates or respecting the financial or organization regulation of electric utilities. The Staff discussion paper sets forth two approaches to be taken to exemption from State law. One would be to analyze the laws of each State and apply the exemptions citing specific sections of State law and regulations. The second approach discussed would be to make a broad proscription from State State laws and regulations which would conflict with the State's implementation of the Commission's rules under section 210.

All of the comments received recommended the broader approach. The Commission believes that such broad exemption is necessary to encourage cogeneration or small power production. Accordingly, subparagraph (c)(1) provides that any qualifying facility shall be exempt from State laws and regulations respecting rates for sales of electric energy to electric utilities, and from financial and organizational regulation of electric utilities.

Subparagraph (c)(2) provides that, upon request of a State regulatory authority a nonregulated electric utility, the Commission may limit the applicability of the broad exemption from the State laws. This provision is intended to add flexibility to the exemption.

The Commission perceives that there may be instances in which a qualifying facility would wish to have an interpretation of whether or not it is subject to a particular State law in order to remove any uncertainty. Under subparagraph (c)(2), the Commission may determine whether a qualifying facility is exempt from a particular State law or regulation.

WRITTEN COMMENTS AND PUBLIC HEARINGS

Interested persons are invited to submit written comments on the proposed regulation to the Office of the Secretary, Federal Energy Regulatory Commission, 825 North Capitol Street, N.E., Washington, D.C. 20426. Comments should reference Docket No. RM79-55 on the outside of the envelope and on all documents submitted to the Commission. In order that the Commission be able to take into account as many comments as possible, the Commission requests that persons submitting comments assist in three ways. First, persons should identify specifically the section or subpart they are addressing. Second, comments should clearly state whether they involve technical, policy or legal matters. Finally, where comments urge a different approach from one presented, specific alternative language should be proposed to the extent practicable.

In addition, the preliminary Environmental Assessment prepared by Commission Staff regarding the Commission's proposed rules implementing sections 201 and 210 of PURPA is available in the Commission's Office of Public Information. As stated in the Request for Further Comment on Proposed Rulemaking Establishing Requirements and Procedures for a Determination of Qualifying Status for Small Power Production and Cogeneration issued today, the Commission is seeking comments on specific issues relating to the preliminary Environmental Assessment.

The Commission has also received many comments in response to the Staff discussion paper and the notice of proposed rulemaking in Docket No. RM79-54. All comments filed in response to those documents are being made part of the record and will be considered in the determination of the final rule in this proceeding.

Fifteen (15) copies should be submitted. All comments and related information received by the Commission by December 1, 1979, will be considered prior to the promulgation of final regulations.

In addition, the Commission will conduct public hearings in several cities at which interested persons will have the opportunity to present their views. Places, dates and times will be announced shortly.

(Public Utility Regulatory Policies Act of 1978, Pub. L. 95-617, Energy Supply and Environmental Coordination Act, 15 U.S.C. § 791 *et seq.*, Federal Power Act, as amended, 16 U.S.C. § 792 *et seq.*, Department of Energy Organization Act, Pub. L. 95-91, E.O. 12009, 42 *Fed. Reg.* 46267)

In consideration of the foregoing, it is proposed to amend Chapter I of Title 18, Code of Federal Regulations, as set forth below.

By direction of the Commission.

(SEAL)

KENNETH F. PLUMB,
SECRETARY

(1) Subchapter K is amended in the table of contents by deleting the title for Part 292 and substituting the following in lieu thereof:

Part 292—Regulation of Small Power Production and Cogeneration Facilities Under Sections 201 and 210 of the Public Utility Regulatory Policies Act of 1978.

(2) Subchapter K is further amended in the table of contents to Part 292 and in the text of the regulations by changing the title to Part 292 and by adding new subparts A, C, and D to read as follows:

Part 292—Regulation of Small Power Production and Cogeneration Facilities Under Sections 201 and 210 of the Public Utility Regulatory Policies Act of 1978.,

SUBPART A—RATES FOR SALES BETWEEN ELECTRIC UTILITIES AND QUALIFYING COGENERATION AND SMALL POWER PRODUCTION FACILITIES

Sec.
292.101 Scope.
292.102 Definitions.
292.103 Availability of Electric Utility System Cost Data.
292.104 Electric Utility Obligations Under This Subpart.
292.105 Rates for Purchases.
292.106 Rates for Sales.
292.107 Simultaneous Purchase and Sale.
292.108 Costs of Interconnection.
292.109 System Emergencies.
292.110 Standards for Operating Reliability.

SUBPART C—IMPLEMENTATION

Sec.
292.301 Implementation by State Regulatory Authorities and Nonregulated Electric Utilities.
292.302 Implementation of Reporting Objectives.
292.303 Waiver.

SUBPART D—EXEMPTION OF QUALIFYING SMALL POWER PRODUCTION FACILITIES AND COGENERATION FACILITIES FROM CERTAIN FEDERAL AND STATE LAWS AND REGULATIONS

Sec.

292.401 Exemptions for Qualifying Facilities from the Federal Power Act.

292.402 Exemptions for Qualifying Facilities from the Public Utility Holding Company Act and Certain State Laws and Regulations.

(Authority: This part issued under the Public Utility Regulatory Policies Act of 1978, Pub. L. 95-617, Energy Supply and Environmental Coordination Act, 15 U.S.C. § 791 *et seq.*, Federal Power Act, as amended, 16 U.S.C. § 792 *et seq.*, Department of Energy Organization Act, Pub. L. 95-91, E.O. 12009, 42 F.R. 46267.)

SUBPART A—ARRANGEMENTS BETWEEN ELECTRIC UTILITIES AND QUALIFYING COGENERATION AND SMALL POWER PRODUCTION FACILITIES UNDER SECTION 210 OF THE PUBLIC UTILITY REGULATORY POLICIES ACT OF 1978

§ 292.101 *Scope.*

(a) *Applicability.* This subpart applies to the regulation of sales and purchases of electric energy and capacity between qualifying cogeneration and small power production facilities and electric utilities.

(b) *Negotiated rates or terms.* Nothing in this subpart—

(1) limits the authority of any electric utility or any qualifying facility to agree to a rate for purchases or sales, or terms or conditions relating to such sales, which differ from the rate or terms which would otherwise be required by this subpart, or

(2) affects the validity of any contract entered into between a qualifying facility and an electric utility.

§ 292.102 *Definitions.*

(a) *General rule.* Terms defined in the Public Utility Regulatory Policies Act of 1978 (PURPA) shall have the

same meaning for purposes of this part as they have under PURPA, unless further defined in this part.

(b) *Definitions:* For purposes of this part:

(1) "qualifying facility" means a cogeneratioin facility or a small power production facility which is a qualifying facility under § 292.208 of the Commission's regulations;

(2) "purchase" means the purchase of electric energy or capacity from a qualifying facility by an electric utility;

(3) "sale" means the sale of electric energy or capacity by an electric utility to a qualifying facility;

(4) "system emergency" means a condition on a utility's system which is likely to result in disruption of service to a significant number of customers or is likely to endanger life or property;

(5) "rate" means any price, rate, charge, or classification made, demanded, observed or received with respect to the sale or purchase of electric energy or capacity, or any rule, regulation, or practice respecting any such rate, charge, or classification, and any contract pertaining to the sale or purchase of electric energy or capacity.

(6) "avoided costs" means the costs to the electric utility of electric energy or capacity or both which, but for the purchase from such cogenerator or small power producer, such utility would generate itself or purchase from another source.

§ 292.103 *Availability of Electric Utility System Cost Data.*

(a) Applicability. (1) Except as provided in subparagraph (2), paragraph (b) applies to each electric utility, in any calendar year, if the total sales of electric energy by such utility for purposes other than resale exceeded 500 million kilowatt-hours during any calendar year beginning after December 31, 1975, and before the immediately preceding calendar year.

(2) Each utility having total sales of electric energy for purposes other than resale of less than one billion kilowatt-hours during any calendar year beginning after December 31, 1975, and before the immediately preceding year, shall not be subject to the provisions of this section until June 30, 1982.

(b) *General Rule.* Not later than June 30, 1980, and every two years thereafter, each regulated electric utility to which this section applies shall provide to its State regulatory authority, and shall maintain for public inspection, and each nonregulated electric utility to which this section applies shall maintain for public inspection, the following data:

(1) the estimated avoided cost of energy on the electric utility's system for various levels of purchases from qualifying facilities. Such levels of purchases shall be stated in blocks of one hundred megawatts or less for systems with peak demand of 1000 megawatts or more, and in blocks equivalent to not more than ten percent of the system peak demand, for systems of less than 1000 megawatts. The avoided costs shall be stated on a cents per kilowatt-hour basis, during daily and seasonal peak and off-peak periods, by year, for the immediately preceding year, and on an estimated cents per kilowatt-hour basis for the current calendar year and each of the next 5 years;

(2) the electric utility's plan and schedule for the addition of capacity, for purchases of firm energy and capacity, and for capacity retirements for each of the next 10 years; and

(3) the estimated costs at completion, on the basis of dollars per kilowatt, of the planned capacity additions and planned firm purchases. These costs should be expressed in terms of individual generating units and by planned firm purchases.

(c) *Special Rule.* Each electric utility (other than any electric utility to which paragraph (b) applies) shall, upon request of a qualifying facility, provide sufficient data to enable such qualifying facility to determine the electric utility's avoided costs for any period described in paragraph (b). If any such electric utility fails to provide such information on request, the qualifying facility may apply to the Commission for an order requiring that the information be provided.

§ 292.104 *Electric Utility Obligations Under This Subpart.*

(a) *Obligation to Purchase from Qualifying Facilities.* Except during periods identified in § 292.105(e), each elec-

tric utility shall purchase in accordance with § 292.105 any capacity or energy which is made available either directly from the qualifying facility or which is transmitted to such utility from the qualifying facility through the facilities of another electric utility.

(b) *Obligation to Sell to Qualifying Facilities.* Each electric utility shall sell to any qualifying facility energy and capacity requested by such qualifying facility in accordance with § 292.106

(c) *Obligation to Interconnect.* Any electric utility shall make all interconnections with any qualifying facility as may be necessary to accomplish purchases or sales under this subpart. The obligations for the costs of any such interconnection shall be determined in accordance with § 292.108.

(d) *Transmission of Purchases to Other Electric Utilities.* If a qualifying facility agrees, an electric utility which would otherwise be obligated to purchase capacity or energy or energy from such qualifying facility may transmit the energy to any other electric utility. Any electric utility to which such energy is transmitted shall purchase such energy under this subpart as if such qualifying facility were supplying energy and capacity directly to such electric utility. The cost of transmission shall be assigned to the qualifying facility pursuant to § 292.108 of these rules. The rate for purchase by the electric utility to which such energy is transmitted shall be adjusted to reflect line losses pursuant to § 292.105(d)(3).

(e) *Parallel Operation.* Each electric utility shall offer to operate in parallel with a qualifying facility, provided that the qualifying facility complies with any relevant standards established pursuant to § 292.110.

§ 292.105 *Rates for Purchases.*

(a) *Rates for Purchases.* Rates for purchases of energy and capacity from any qualifying facility:

(1) shall be just and reasonable to the electric consumer of the electric utility and in the public interest;

(2) shall not discriminate against qualifying cogeneration and small power production facilities; and

(3) shall not exceed the avoided costs of such a purchase. There is a rebuttable presumption that the rate for purchase meets the requirements of this paragraph if the rate reflects the avoided costs resulting from such purchase as determined on the basis of the cost of energy and capacity set forth pursuant to § 292.103(b) or (c).

(b) *Tariffs for Purchases From Facilities of Ten Kilowatts or Less.* Each electric utility, upon request of a qualifying facility, shall establish a tariff or other method for setting forth standard rates for purchases from qualifying facilities with a design capacity of 10 kilowatts or less.

(c) *Purchases "As Available" or Pursuant to a Legally Enforceable Obligation.* A qualifying facility shall have the option either to provide energy or capacity to an electric utility—

(1) as the qualifying facility determines such energy or capacity to be available for such purchases, in which case the rates for such purchases may be based on the purchasing utility's avoided energy costs, or

(2) pursuant to a legally enforceable obligation for the delivery of energy or capacity at a future date, in which case the rates for purchases may be based on estimates of future avoided costs of energy or capacity.

(d) *Factors Affecting Rates For Purchases.* In implementing the provisions of this subpart, a State regulatory authority (with respect to any electric utility over which it has ratemaking authority) or nonregulated electric utility shall consider with regard to rates for purchases the following factors:

(1) the availability of capacity from a qualifying facility during system daily and seasonal peak periods, including—

(i) the ability of the utility to dispatch the qualifying facility;

(ii) the qualifying facility's ability and willingness to provide energy or capacity during system emergencies;

(iii) the length, frequency, and scheduling flexibility of scheduled maintenance by the qualifying facility;

(iv) the expected or demonstrated reliability of the qualifying facility; and

(v) the length of any contract term between the electric utility and the qualifying facility and its termination notice requirements or the length of any legally enforceable obligation to provide energy or capacity undertaken by the qualifying facility;

(2) the relationship of energy or capacity from a qualifying facility to an electric utility's capacity and energy needs as expressed in § 292.103, including:

(i) the ability of the electric utility to reduce or avoid costs, including the deferral of capacity additions, as a result of the availability individually or in the aggregate from qualifying facilities; and

(ii) the smaller capacity increments and the shorter lead times available with additions of capacity from qualifying facilities; and

(3) the costs or savings resulting from variations in line losses from those that would have existed in the absence of purchases from a qualifying facility, if the purchasing electric utility generated or purchased an equivalent amount of electric energy.

(e) *Periods During Which Purchases Not Required.* An electric utility will not be required to purchase electric energy and capacity during any period identified by the State regulatory authority having jurisdiction over the rates of such utility, or the nonregulated electric utility, during which purchases from qualifying facilities might result in costs greater than those which the utility would incur if it did not make such purchases, but instead generated or purchased an equivalent amount of electric energy.

§ 292.106 *Rates for Sales.*

(a) *General Rules.* (1) Rates for sales shall not discriminate against any qualifying facility in comparison to rates for sales to other customers served by the electric utility. Rates for sales shall be just and reasonable and in the public interest.

(b) Each electric utility shall provide electric energy and capacity and other services to any qualifying facility, at a rate at least as favorable as would be provided to a customer who does not have his own generation. The costs of in-

terconnection shall be assigned pursuant to § 292.108 of this part.

(c) *Additional Services to be Provided by Qualifying Facilities.* Each electric utility shall provide to any qualifying facility the following types of service, even if such types of service are not provided to other retail customers:

(1) supplementary power;

(2) back-up power;

(3) interruptible power; and

(4) maintenance power.

(d) *Rates for Sales of Back-Up and Maintenance Power.* The rate for sales of back-up power or maintenance power—

(1) shall not be based upon an assumption (unless supported by factual data) that forced outages or other reductions in electric output by all qualifying facilities on an electric utility's system will occur simultaneously;

(2) shall not be based upon an assumption (unless supported by factual data) that forced outages or other reductions in electric output by all qualifying facilities will occur during the system peak; and

(3) shall take into account the extent to which a qualifying facility has coordinated periods of scheduled maintenance with such electric utility.

§ 292.107 *Simultaneous Purchase and Sale.*

A qualifying facility shall be permitted to receive rates established pursuant to § 292.105(a) for the electric energy and capacity generated by the facility, while simultaneously buying energy and capacity from such utility for use in the facility at rates established in accordance with § 292.106(a), to the extent that such purchases are produced by capacity the construction of which was commenced after the date of issuance of this part.

§ 292.108 *Costs of Interconnection.*

(a) *Definition.* For purposes of this subpart, "interconnection costs" means the costs of connection, switching, metering, transmission, safety provisions and other costs incurred by the utility reasonably resulting from intercon-

nected operation between an electric utility and a qualifying facility.

(b) *Reimbursement for Interconnection Costs for Purchases.* Each qualifying facility must reimburse any electric utility which purchases capacity or energy from such qualifying facility for any interconnection costs. These costs are limited to those costs which the purchasing utility would incur if it did not make such purchases but instead generated an equivalent amount of electric energy itself or purchased an equivalent amount of electric energy from other sources.

(c) *Reimbursement for Interconnection Costs for Sales.* Each qualifying facility must reimburse any electric utility which sells capacity or energy to such qualifying facility for any interconnection costs. The apportionment of interconnection costs between such qualifying facility and electric utility under this paragraph shall not discriminate against any qualifying facility in comparison to any other customers served by the electric utility.

§ 292.109 *System Emergencies.*

(a) *Qualifying facility obligation to provide power during system emergencies.* A qualifying facility shall be required to provide energy or capacity to an electric utility during a system emergency only to the extent provided by agreement between such qualifying facility and electric utility or to the extent ordered under section 202(c) of the Federal Power Act.

(b) *Discontinuance of Purchases and Sales During System Emergencies.* During any system emergency, an electric utility may discontinue—

(1) purchases from a qualifying facility if such purchases would contribute to such emergency; and

(2) sales to a qualifying facility, provided that such discontinuance is on a nondiscriminatory basis.

§ 292.110 *Standards for Operating Reliability.*

Any qualifying facility may be subject to reasonable standards to ensure system safety and reliability in interconnected operations. Such standards may be recommended by any electric utility, or by any other person.

Each State regulatory authority (with respect to any electric utility over which it has ratemaking authority) or any nonregulated electric utility may establish such standards as it determines necessary to carry out the purposes of this section. Such standards must be accompanied by a statement setting forth the need for such standards on the basis of system safety and reliability requirements.

* * * * *

SUBPART C—IMPLEMENTATION

§ 292.301 *Implementation by State Regulatory Authorities and NonRegulated Electric Utilities.*

(a) *State Regulatory Authorities.* Not later than one year after these rules take effect, each State regulatory authority shall, after notice and an opportunity for public hearing, commence implementation of Subpart A (other than § 292.103 thereof). Such implementation may consist of the issuance of regulations; an undertaking to resolve disputes between qualifying facilities and electric utilities arising under Subpart A, or any other action reasonably designed to implement such subpart (other than § 292.103 thereof).

(b) *Nonregulated Electric Utilities.* Not later than one year after these rules take effect, each non-regulated electric utility shall, after notice and an opportunity for public hearing, commence implementation of Subpart A (other than §292.103 thereof). Such implementation may consist of the issuance of regulations, an undertaking to comply with Subpart A, or any other action reasonably designed to implement such subpart (other than § 292.103 thereof).

(c) *Reporting Requirement.* Not later than one year after these rules take effect, each State regulatory authority and nonregulated electric utility shall file with the Commission a report describing the manner in which it will implement Subpart A (other than § 292.103 thereof.

§ 292.302 *Implementation of Reporting Objectives.*

Any electric utility which fails to comply with the requirements of § 292.103(b) shall be subject to the same penalties to which it may be subjected for failure to comply

with the requirements of the Commission's regulations issued under section 133 of PURPA.

§ 292.303 *Waivers*

(a) *State regulatory authority and non-regulated utility waivers.* Any State regulatory authority or nonregulated electric utility may apply for a waiver from the application of any of the requirements of Subpart A (other than § 292.103 thereof).

(b) *Electric utility waiver.* Any electric utility may apply for a waiver from the application of any of the requirements of § 292.103(c).

(c) *Commission action.* The Commission will grant such a waiver only if an applicant under paragraph (a) or (b) demonstrates that compliance with the requirements of Subpart A or § 292.103, as the case may be, is not necessary to encourage cogeneration and small power production and is not otherwise required under section 210 of PURPA.

SUBPART D—EXEMPTION OF QUALIFYING SMALL POWER PRODUCTION FACILITIES AND COGENERATION FACILITIES FROM CERTAIN FEDERAL AND STATE LAWS AND REGULATIONS

§ 292.401 *Exemptions for Qualifying Facilities from the Federal Power Act.*

(a) *Applicability.* This section applies to:

(1) qualifying cogeneration facilities, and

(2) qualifying small power production facilities which have a power production capacity which does not exceed 30 megawatts.

(b) *General Rule.* Any qualifying facility described in paragraph (a) shall be exempt from all sections of the Federal Power Act, except—

(1) Sections 1–30;

(2) Section 202(c);

(3) Section 305(c); and

(4) any necessary enforcement provision of Part III with regard to the sections listed in (1), (2) and (3).

§ 292.402 *Exemptions for Qualifying Facilities from the Public Utility Holding Company Act and Certain State Laws and Regulations.*

(a) *Applicability.* This section applies to any qualifying facility described in § 292.401(a), and to any qualifying small power production facility with a power production capacity over 30 megawatts if such facility produces electric energy solely by the use of biomass as a primary energy source.

(b) *Exemption from the Public Utility Holding Company Act of 1935.* Any qualifying facility described in paragraph (a) shall not be considered to be an "electric utility company" as defined in section 79(b)(3) of the Public Utility Holding Company Act of 1935.

(c) *Exemption from Certain State Laws and Regulations.*

(1) Any qualifying facility shall be exempted from State laws and regulations respecting:

(i) the rates for sales of electric energy by qualifying cogeneration and small power production facilities to electric utilities; and

(ii) the financial and organizational regulation of electric utilities.

(2) Upon request of a State regulatory authority or nonregulated electric utility, the Commission may consider any limitation of the application of subparagraph (1).

(3) Upon request of any person, the Commission may determine whether a qualifying facility is exempt from a particular State law or regulation.

CULLEN AND DYKMAN
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(212) 855-9000

December 14, 1979

Hon. Kenneth F. Plumb
Secretary
Federal Energy Regulatory Commission
825 North Capitol Street, N.E.
Washington, D.C. 20426

Re: Small Power Production and Cogeneration Facilities
—Qualifying Status—Docket No.RM79-54
—Rates and Exemptions—Docket No. RM79-55

Dear Mr. Plumb:

Enclosed for filing with the Commission in the above proceedings are an original and fourteen copies of the Additional Comments of The Brooklyn Union Gas Company.

Kindly acknowledge receipt of the enclosures on the enclosed copy of this letter. A self-addressed envelope is also enclosed for your convenience.

Yours truly,

Michael W. Hall

MWH:ys
Enclosures

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

In the Matter of

SMALL POWER PRODUCTION
AND COGENERATION
FACILITIES—QUALIFYING STATUS

and

SMALL POWER PRODUCTION
AND COGENERATION
FACILITIES—RATES AND EXEMPTIONS

Docket No. RM 79-54

Docket No. RM 79-55

ADDITIONAL COMMENTS OF *THE BROOKLYN UNION GAS COMPANY*

By notices issued October 18[1] and 19[2], 1979, the Commission has requested comments on: (1) a proposed rule under which small power production facilities (SPPF) and cogeneration facilities (CF) will be able to obtain the status of "qualifying" facilities under Section 201 of the Public Utility Regulatory Policies Act of 1978 (PURPA) and (2) a proposed rule respecting the criteria which SPPFs and CFs must meet to be exempt from certain state and federal laws and regulations, the conditions under which SPPFs and CFs can be interconnected with electric utilities, the types of service to be offered by electric utilities to "qualifying facilities" and the rates for such services and for sales of electricity by "qualifying facilities" to electric utilities.

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[1] Notice of Proposed Rulemaking Regarding the Implementation of Section 210 of the Public Utility Regulatory Policies Act of 1978, Docket No. RM79-55, issued October 18, 1979.

[2] Request For Further Comments on Proposed Rulemaking Establishing Requirements and Procedures For A Determination of Qualifying Status for Small Power Production and Cogeneration Facilities, Docket No. RM79-54, issued October 19, 1979.

The Brooklyn Union Gas Company (Brooklyn Union) has filed comments[3] in these proceedings in response to the Commission's June 27, 1979 Notice of Proposed Rulemaking in Docket No. RM79-54 and a Staff paper issued in Docket No. RM79-55[4]. Brooklyn Union has reviewed those comments in light of the Commission's notices of October 18 and 19, 1979, and believes that nothing has occurred which would change the views expressed on the matters addressed therein. Accordingly, the following comments are in addition to, and intended to supplement, Brooklyn Union's August 1, 1979 comments herein.

I.

BROOKLYN UNION' OPERATIONS AND INTEREST

Brooklyn Union is engaged primarily in the provision of retail gas service to approximately 4,000,000 consumers in a service area located within the City of New York. Brooklyn Union and a subsidiary company have been engaged for many years in the sale and financing of gas-fired appliances and equipment. Brooklyn Union provides gas service to a number of cogeneration facilities, and is engaged in a research and development program to study the reliability, economics, and market for various types of cogeneration equipment. Brooklyn Union has assisted its customers in the design and installation of cogeneration equipment. In addition, Brooklyn Union has conducted studies of projects involving small power production facilities.

The terms and rates for electric utility standby service for cogenerators in New York City are prohibitive. For certain types of cogeneration facilities which require parallel electric utility service, such service is simply not available in New York City. For these reasons, none of Brook-

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[3] See Comments of The Brooklyn Union Gas Company dated August 1, 1979.

[4] Staff Paper Discussing Commission Responsibilities to Establish Rules Regarding Rates and Exemptions for Qualifying Cogeneration and Small Power Production Facilities Pursuant to Section 210 of the Public Utility Regulatory Policies Act of 1978, Docket No. RM79-55, issued June 26, 1979.

lyn Union's existing cogeneration customers are interconnected with an electric utility system. Consequently, and because of various regulatory impediments, the CFs served by Brooklyn Union make no sales of electricity to electric utilities and have installed redundant equipment in lieu of standby utility service.

For all of the foregoing reasons, Brooklyn Union and the Consumers it serves have a direct and substantial interest in the rules proposed and issues presented in these dockets.

II.

COMMENTS ON QUALIFICATION RULES

The Commission's October 19, 1979 Request for Further Comments summarized tentative conclusions reached in a Preliminary Environmental Assessment of the environmental impact of the proposed rules and requested comments on (1) proposed findings, including a finding that oil-fired diesel cogeneration facilities *may* significantly affect the environment under certain circumstances and (2) certain substantive or procedural modification of the proposed rules which might mitigate any potential adverse effects of the rules. See October 19, 1979 Request for Further Comments, *mimeo*, pp. 5, 9-11.

With respect to the conclusions reached in the Preliminary Environmental Assessment regarding diesel cogeneration, Brooklyn Union notes first that potentially significant environmental impacts *may* occur only in major high-density urban areas, in a commercial/residential setting and only where the proposed rules would encourage installation of multiple units within the same geographical area. Environmental Assessment, pp. 29, 30 (Figure 2) and 93. Since the rules which this Commission will issue will be *national* in scope, any across-the-board denial to oil-fired diesel facilities of the benefits accruing to a qualifying facility cannot properly be based upon tenuous conclusions which are valid, *if at all*, only in very limited areas of the country. Moreover, such a blanket proscription regarding diesel cogeneration would be likely to have a chilling effect on the further development of this cogeneration technolo-

gy. In light of the fact that at the overall efficiency standard required by proposed Section 292.206(e), a diesel cogenerator will be 1.8 to 2.4 times as fuel efficient as the average central electric generating station, Brooklyn Union submits that such a radical "cure" for the environmental impacts which *may* be potentially significant is not only inconsistent with Congress' intent to foster the more efficient use of fuel resources but is illogical.

There is additional evidence that outright prohibition of, or strict limitations on, the grant of qualifying facility status to diesel cogeneration facilities is not warranted, at least at the present time. Both the Preliminary Environmental Assessment (p. 29) and the Commission's Request for Further Comments (p. 5) acknowledges that factors such as the rising price of diesel fuel and uncertainty concerning the continuing availability of liquid fuels will limit the proliferation of oil-fired diesel cogeneration and, therefore, the potential environmental impact of this technology. Moreover, in highly developed urban areas where the potential environmental impacts of diesel cogeneration have been predicted to be potentially significant, existing environmental controls, including the National Ambient Air Quality Standards, will provide an additional limitation on the number of oil-fired diesel cogeneration facilities which can be installed. Preliminary Environmental Assessment, p. 29.

For the foregoing reasons, Brooklyn Union submits that no convincing case has been made for excluding diesel cogenerators from the benefits accorded to qualifying facilities. In this regard, in light of the Preliminary Environmental Assessment's basic conclusion that further study is necessary, Brooklyn Union respectfully suggests that oil-fired diesel cogeneration facilities meeting the efficiency criteria established by the Commission be accorded qualifying facility status at least until actual operating data can be gathered which will permit meaningful analysis of the nature and extent of the environmental effects of such facilities.

No matter how the Commission may elect to treat *new* oil-fired diesel cogeneration facilities in its final rule herein,

there is no logical basis for denying qualifying facility status to *existing* diesel cogenerators. Unless such facilities are large enough to be subject to the provisions of the Power Plant and Industrial Fuel Use Act, they will continue to use fuel oil whether or not they receive the benefits which Section 210 of PURPA confers upon qualifying cogeneration facilities. Consequently, any modification of the proposed rules which would have the effect of denying the benefits of this program to existing diesel cogenerators can only result in less efficient use of fuel resources, contrary to the intent of Congress.

Certain parties to these proceedings have urged the Commission to impose sweeping fuel use restrictions which would deny qualifying facility status to CFs using oil or natural gas. In support of such restrictions, these parties have argued (1) that the environmental impact of gas-fired CFs can be equated with that of oil-fired diesel CFs[5] and (2) that "policy considerations" require the Commission to discourage the use of natural gas in CFs. These arguements are without basis in fact or in logic.

The Preliminary Environmental Assessment concluded (p. 45):

> Benefits available under the Commission's rules to exist[ing] gas-fired cogeneration facilities can only result in increased use of natural gas and reduced use of oil.

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[5] Parties making this argument have submitted studies in these proceedings which purport to demonstrate that installation of additional oil-fired diesel cogeneration facilities will have a significant adverse impact on the environment in densely populated areas. The electric utility sponsors of these studies and other parties have attempted to use them to "tar" gas-fired cogeneration facilities with the "brush" of conclusions respecting the environmental effects of oil-fired diesel cogeneration. Brooklyn Union's review of these studies indicates that they are (1) based on contrary-to-fact assumptions regarding the price and availability of diesel fuel, capital costs, the timing of facilities' installation and taxes, (2) so limited with respect to the area of environmental impact considered that they are useless in analyzing the environmental impacts outside the specific areas of study and (3) clearly without application directly or by analogy to any other cogeneration technology, including gas-fired and dual fuel cogeneration.

> Consequently, the environmental effect of the Commission's rules on such facilities is positive.

Moreover, with respect to specific gas-fired cogeneration technologies considered in the Preliminary Environmental Assessment's, the potential environmental impacts compared favorably with the impact of oil-fired diesel CFs. For example, with respect to dual fuel engines which use both oil and natural gas, the Environmental Assessment observed (p. 44):

> Generally, natural gas is available during the spring, summer, and fall. Interruptions of gas supply, with the resulting diesel operation is likely to occur during the winter, if at all. This fact should mitigate the air quality impacts, since gas operation would be the norm during the summer months when air quality problems are most pronounced.

The Preliminary Environmental Assessment's analysis of the environmental effects of dual fuel and other gas-fired cogeneration technologies is consistent with the operating experience of the gas-fired CFs served by Brooklyn Union. Attached hereto as Appendix A is a recent study prepared by Fred C. Hart Associates entitled "Cogeneration In The Brooklyn Union Gas Company Service Area". That study concludes that the CFs in Brooklyn Union's service territory, which burn both gas and oil, do not impose inordinate burdens on the environment.

As noted above, none of Brooklyn Union's existing cogeneration customers are presently interconnected with an electric utility system. Due primarily to terms and rates for utility standby service which are prohibitive, and the unavailability of parallel electric service for those CFs requiring such service, these CFs have installed redundant equipment. Accordingly, only beneficial environmental effects can be anticipated to result from a Commission rule conferring qualifying facility status on these CFs.[6]

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[6] These beneficial environmental effects include a reduction in environmentally harmful emissions from utility central generating stations, reduced use of oil (approximately 68% of the electricity distributed by the utility providing electric service in Brooklyn Union's service territory is derived from oil-fired electric generation stations) and im-

The policy arguments of these parties are equally lacking in merit. These parties do not claim, nor could they, that Congress intended to deny gas-fired CFs the benefits of qualifying facility status under Title II of PURPA. Brooklyn Union submits that Congress' prescription of an over 100 million Btu per hour threshold for electric power plants and major fuel burning installations subject to the prohibitions against use of oil or gas in the Power Plant and Industrial Fuel Use Act, the absence of a specific prohibition against the use of gas by qualifying CFs under Title II of PURPA, and the provision of an exemption from incremental pricing for gasfired CFs in Section 206(c) (3) of the Natural Gas Policy Act of 1978 (NGPA) all manifest a conscious Congressional design to include gasfired cogeneration among the cogeneration technologies to be encouraged by this Commission. If anything, the fact that Congress extended to gas-fired CFs protection from higher energy costs in the NGPA—*a "benefit" not extended to any other cogeneration technology*—indicates Congress' recognition of the special role gas-fired CFs can and will play in maximizing fuel use efficiency.

Among those parties most vociferously opposing the use of natural gas for "inferior" cogeneration purposes are electric utilities which are actively engaged in dissipating this nation's "gas bubble" by using gas as boiler fuel in the generation of electricity. In light of the efficiency standards which the Commission has proposed for gas-fired CFs which seek qualifying facility status, Brooklyn Union submits that the twin goals of conserving natural resources and maximizing fuel use efficiency could be better achieved by use of natural gas in CFs which meet the Commission's efficiency standards and the termination, at the *earliest possible date*, of programs which encourage or permit consumption of vast quantities of natural gas in comparatively inefficient utility central electric generating stations.

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proved fuel use efficiency. In addition, the location of these CFs in relation to the electric utility's central generating stations indicates that additional energy savings will result from reduced transmission line losses.

Finally, Brooklyn Union submits that the reasoning employed and the result reached on the issue of fuel use restrictions in the Commission's June 27, 1979 Notice of Proposed Rulemaking in Docket No. RM79-54 is persuasive and should be dispositive of this issue:

> Under PURPA, the Commission may establish fuel use requirements for qualifying cogenerators of any size, but any such requirements regarding the use of natural gas or petroleum would only be effective at fuel heat input levels below the thresholds established by FUA for action by the Secretary of Energy. At such lower levels, a fuel burning installation that does not seek classification as a qualified cogenerating facility would not be subject to an FERC rule and could burn natural gas or oil for cogeneration, imposed by the Commission, could discourage cogeneration at the lower heat input levels, while not significantly reducing the use of oil or natural gas. *We conclude that restrictions or requirements on fuel use by qualifying cogeneration facilities are not appropriate in this proposed rule.*
>
> June 27, 1979, Notice
> of Proposed Rulemaking,
> p. 22-3 (emphasis added)

For all of the foregoing reasons, Brooklyn Union urges the Commission not to impose the burden of fuel use restrictions on the cogeneration technologies available to be employed in achieving the goal of optimum fuel use efficiency.

In its August 1, 1979 Comments in these proceedings, Brooklyn Union urged the Commission to modify the rule proposed in Docket No. RM79-54 (1) to provide a self-executing mechanism for qualification of cogeneration facilities having an aggregate electric generation capacity of 250 kilowatts or less; and (2) to substitute a single overall *annual* energy efficiency standard for the energy efficiency standards prescribed in proposed Sections 292.206(d), (e) and (f). Brooklyn Union continues to believe that such modifications are necessary to encourage wide-spread participation by cogenerators and would maximize the benefits of

the program. Accordingly, we urge the Commission to incorporate such modifications into its final rule herein.

III

COMMENTS ON DOCKET NO. RM79-55

Brooklyn Union strongly supports the Commission's conclusion (October 18, 1979 Notice of Proposed Rulemaking, p. 19-22) that the authority to require interconnection of electric utility systems with qualifying cogeneration facilities is inherent in Section 210 of PURPA. Requiring cogenerators to make cumulative and unnecessary filings and issuing redundant determinations regarding qualifying status and interconnections would plainly counter to, and the Congressional purpose of removing regulatory impediments to the most efficient use of fuel resources by cogenerators and electric utility systems. Accordingly, we urge the Commission to provide that once a CF has achieved qualifying facility status under the rules proposed in Docket No. RM79-54, there is no need for a separate application under Sections 202 and 204 of PURPA to interconnect such qualifying facility with an electric utility system.

Brooklyn Union strongly supports the requirement in proposed Section 292.104(e) of the rule that electric utilities offer to operate in parallel with a qualifying facility. The requirement for parallel operations is crucial. Although many types of cogeneration facilities must operate in parallel with an electric utility, we understand that such parallel operation is presently prohibited in New York City and may be prohibited elsewhere. Accordingly, the requirement that electric utilities offer to operate in parallel with qualifying CFs will serve to broaden the choice of cogeneration technologies which will be available to achieve the goal of maximum fuel use efficiency.

In Section 292.106(c), the Commission has proposed to require electric utilities to provide certain types of service to qualifying CFs even if such services are not provided to other retail customers. Brooklyn Union strongly supports this proposal. The availability of such services to qualifying CFs will eliminate significant impediments to the efficient operation of cogenerators, insure that new CFs can be in-

stalled without costly redundant equipment and maximize the benefits of interconnection between qualifying cogenerators and electric utility systems. With respect to supplementary power, Brooklyn Union understands that a potential qualifying CF could install cogeneration equipment capable of producing something less than all of its electric power requirements and purchase additional electric power from an electric utility under the applicable rate schedule for that customer's class. Such service should give a CF a wider choice in the purchase or design of cogeneration equipment, so that the overall mix of electricity and steam or other forms of useful energy produced can be more closely tailored to the particular needs of that facility. This in turn will help the qualifying CF to achieve the maximum fuel use efficiency, and with a minimum commitment of resources.

CONCLUSION

The Brooklyn Union Gas Company respectfully requests that the foregoing comments and those previously filed herein on August 1979 be taken into account by the Commission in developing rules in these proceedings.

Respectfully submitted,

The Brooklyn Union Gas Company

By:

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William R. Coleman
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Brooklyn, New York 11201
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Its Attorneys

Dated: December 14, 1979

VERIFICATION

STATE OF NEW YORK)
: ss.:
COUNTY OF KINGS)

Michael W. Hall, being duly sworn, deposes and says: that he is an attorney for The Brooklyn Union Gas Company; that he is authorized to verify and file the foregoing document; that he has examined the statements contained therein and that all such statements are true and correct to the best of his knowledge, information and belief.

Sworn to before me this
14th day of December, 1979

ROSELLEEN T. HORN
Notary Public, State of New York
No. 24-4683250
Qualified in Kings County
Commission Expires March 30, 1981

COGENERATION IN THE BROOKLYN UNION GAS COMPANY SERVICE AREA

Prepared by:

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May, 1979

COGENERATION IN THE BROOKLYN UNION GAS COMPANY SERVICE AREA

Introduction

This paper presents information gathered on eight cogeneration facilities currently operating in the Brooklyn Union Gas Company service area. Data were obtained through site visits to each of the eight facilities and discussions with plant engineers and plant managers. This data supplements information already on file at Brooklyn Union Gas Company.

The data were analyzed primarily to:

1. document the operating history of the eight plants;
2. identify the environmental impacts of cogeneration in the New York City area; and
3. determine the economics of cogeneration in the New York City area.

The conclusions presented represent best engineering estimates of the plant's operation, backed up whenever possible with documented data. A detailed case study of one of the eight plants was completed in October, 1977*, and the conclusions presented therein generally agree with, and therefore reinforce, the information gathered on all the facilities.

General Description of the Facilities

The eight facilities surveyed are: (1) Rochdale Village in Jamaica, Queens; (2) Amalgamated Warbasse Houses in Brooklyn; (3) Starrett City in Brooklyn; (4) Kings Plaza Shopping Center in Brooklyn; (5) New York Telephone Company at 111 Livington Street in Brooklyn; (6) Revere Sugar Corporation in Brooklyn; (7) Amstar Sugar Refinery in Brooklyn; and (8) Procter and Gamble in Staten Island. These eight facilities represent a variety of operating conditions in terms of facility type, size, age, and energy re-

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*"Case Study of Total Energy at Rochdale Village", Vol. I and II, submitted to Argonne National Laboratory by Brooklyn Union Gas Company, October 28, 1977.

quirements. Three are large residential developments (Rochdale Village, Warbasse Houses, and Starrett City); two are commercial/office complexes (Kings Plaza and New York Telephone); and three are industrial plants (Revere Sugar, Amstar Sugar, and Procter and Gamble).

The types of facilities and equipment cover a spectrum of applications including a range of sizes, fuel availabilities and energy demands. The three apartment complexes use a combination of steam turbine generators and dual-fuel diesel engine generators to produce electricity and steam. The two commercial/office complexes use only dual-fuel diesel engine generators, while two of the three industrial plants (Revere Sugar and Amstar Sugar) use only steam turbine generators due to high process steam demands. The remaining industrial plant (Proctor and Gamble) uses a steam turbine and dual-fuel diesel generator combination.

These facilities range in age from 5 to 89 years. The installed electrical capacity of these energy systems varies from 2,500 kw to 18,000 kw. All but one (Revere Sugar) provide 100 percent of the electricity required on-site and have more than sufficient back-up capacity to supply the peak electrical demand. Of the eight facilities, only Revere Sugar is hooked up to the Consolidated Edison electrical grid. Moreover, this connection is not in parallel. Only certain isolated loads are carried on Con Edison's grid.

Seven of the eight facilities use natural gas as their primary fuel, supplied on an interruptible basis by Brooklyn Union, and #2 or #6 oil as a secondary fuel. For the foreseeable future, gas will be available to these facilities for 10 out of 12 months per year. New York Telephone Company currently uses only oil.

The following sections discuss, in greater detail, system performance, environmental impacts, and the economics of cogeneration at these eight cogeneration facilities.

System Operations

System Performance. Plant managers and operators at the eight cogeneration facilities expressed a high level of satisfaction with the performance of their facilities. Rea-

sons cited for this satisfaction include (1) high equipment reliability; (2) very low frequency and duration of system outages; and (3) minimal equipment maintenance and repair problems.

The frequency of system outages at four of the facilities has been much less than one per year. This group of sites includes the three residential complexes and Kings Plaza Shopping Center. Rochdale Village, which has been in operation for 14 years, has had no complete loss of power and has never had to use its emergency generation equipment.

At the remaining four sites, including the three industrial complexes and one office building, the frequency of major outages has been on the order of only once per year. The higher frequency of outages in this group of facilities, as compared to the others, can be attributed to more severe operating conditions. The equipment in these facilities is operated at peak rates for longer periods of time, and the frequency of scheduled downtime for maintenance is much lower. This is particularly true in the industrial facilities which tend to include less back-up capacity in their system design.

The duration of the "worst-case" system outages for these facilities ranged from 30 minutes to 10 hours. The average duration of a major system outage was estimated by most plant managers to be in the order of 1-4 hours. In only one instance did an outage of more than 30 minutes result in total blackout of power and heat. This occurred during the fall of 1973 at Kings Plaza Shopping Center when, during a hurricane, water infiltrated to the motor control equipment and caused the system to short out. Total down time was one hour and 15 minutes. In other cases, emergency equipment came on line with a minimum of service disruption.

Maintenance. The plant managers and engineers at each of the eight facilities emphasized the importance of an effective preventive maintenance program and monitoring of equipment performance. All facilities are equipped to do a substantial amount of maintenance in-house, and most perform equipment checks on a regular basis.

Operation of the maintenance programs at these facilities has been handled by a group of engineering, mechanic and operatoring personnel. Minor repairs and servicing are provided as required. Overhauls of major equipment are scheduled on a regular basis. The manufacturers of the equipment will generally make recommendations for maintaining the equipment, from which an organized maintenance program can be devised.

The maintenance programs at Revere Sugar and Starrett City demonstrate the range in programs at the eight facilities. At Revere Sugar, minimal maintenance is required under normal operation. Minor equipment runs basically until it fails, then spares are brought on line and repairs are made. Major equipment is taken off line and checked approximately every two years.

Starrett City has an in-house operating and maintenance staff of 33 people who work in 5 rotating groups, 24 hours/day, 7 days/week. Spring and fall maintenance is performed on the heavy equipment. Boiler inspections occur twice per year. It is important to note that the Starrett City cogeneration plant runs continuously 24 hours a day to furnish the site's 6000 dwelling units with all electrical, heating, and air conditioning requirements on a year round basis.

The importance of preventive maintenance is emphasized by the experience of New York Telephone. At this facility, equipment performance is not as good as desired. Poor preventive maintenance by the previous system operator has been identified as the probable cause of the present problems.

Balance of Thermal and Electrical Load. To obtain optimum total system efficiency, the thermal and electrical demands on the system should be balanced so that waste heat captured during the generation of electricity is sufficient to satisfy all heating, air conditioning, and/or process requirements without substantial discharge of heat to the atmosphere and without need for supplemental steam generation. Unfortunately, few individual sites can precisely balance their thermal and electric demands.

TABLE 1

ELECTRICAL AND THERMAL LOADS OF COGENERATION SYSTEMS

FACILITY	AGE (YEARS)	EQUIPMENT USED	ELECTRICITY		ARE ALL ENERGY NEEDS MET BY OPERATION OF ELECTRICAL GENERATION EQUIPMENT?		IS STEAM WASTED?
			INSTALLED CAPACITY (kw)	PEAK OPERATING DEMAND** (kw)	ELECTRICITY	STEAM	
Rochdale Village	16	steam turbines diesel engines (dual fuel)	18000	9800	Yes	Yes	No
Amstar Sugar	89	steam turbines	9500	6000	Yes	No turbine bypass used	No
Kings Plaza	9	diesel engines (dual fuel)	11000	7500	Yes	No additional boiler used	No
Warbasse Houses	15	steam turbines diesel engines	12500	4200	Yes	No turbine bypass used	No
Revere Sugar	45	steam turbines	2500	5000	No utility tie-in used	No	No
Starrett City	5	steam turbines diesel engines (dual fuel)	18000	11200	Yes	Yes	Yes
New York Telephone Company	10	diesel engines (dual fuel)	5000	2100	Yes	No additional boiler used	No
Proctor and Gamble	9*	steam turbines diesel engines	14500	8000	Yes	Yes	No

NOTES:
* Conversion began in 1970 and was completed in 1974.
** Estimates obtained from facilities personnel.

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Nevertheless, near optimum total system efficiencies can still be achieved when thermal demand exceeds electrical demand, since supplemental steam can be generated at greater than 80 percent efficiency. In this case, the cogeneration system is sized to meet peak electrical demand and supplemental steam is generated on-site.

The least efficient situation exists when heat must be wasted because electrical demand exceeds thermal demand. This situation can be remedied somewhat if hook-ups to the local utility are available and supplemental electricity can be purchased at a reasonable rate.*

Table 1 displays the electrical generation characteristics and the thermal/electrical load balance of the eight facilities. Rochdale Village and Procter and Gamble have a near optimum balance of thermal and electrical load. All electrical and thermal needs are met by operation of the cogeneration equipment, and little energy is wasted. Thermal demand exceeds electrical demand at five of the facilities, American Sugar, Kings Plaza, Warbasse Houses, New York Telephone, and Revere Sugar. The first four of these generate all required electricity on-site and supplement the thermal load with either turbine bypasses or additional boilers. Revere Sugar currently generates only 50 percent of its electrical requirements and purchases the remainder from Consolidated Edison, to power certain isolated loads.

At only one of the eight facilities, Starrett City, did steam generation from waste heat actually exceed current thermal requirements. The excess is not great and plans to supply thermal energy to a neighboring facility are currently being investigated.

An overall analysis of the thermal/electrical load balance characteristics of the eight facilities studied indicates that relatively little thermal energy is wasted.

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*If the cogenerator connects to an electrical utility grid and is allowed to sell as well as purchase electricity, optimum fuel savings and other benefits accrue to the generator, even though total system efficiency will decrease.

Standby Capacity vs. Utility Tie-Ins. As is evident in Table 1, all of the eight facilities, except Revere Sugar, were designed to have substantial amounts of standby electrical generation capacity. The standby equipment is essential to enhance system reliability, to insure coverage during equipment breakdowns, and to permit the periodic shutdown of equipment for maintenance. An autonomous cogeneration plant (one not connected to the local electric utility grid) must be oversized in order to meet its peak electrical demand even with some equipment failure.

A grid-connected cogenerator does not require standby electrical generation capacity, and thus will incur lower capital costs than an autonomous plant. Optimum fuel savings and other benefits accrue to the grid-connected cogenerator that is allowed to sell as well as buy electricity. Unfortunately, at the time they were designed and constructed, most of these eight facilities encountered a high degree of resistance from the local electric utility to a grid-connection. Due primarily to the excellent performance histories of their energy systems, and the high hookup and standby rates for purchased electricity, the plant managers of the seven autonomous facilities are presently content to remain independent.

Should reasonable rates for an electrical grid tie-in become available in the future* new cogeneration facilities could be sized with less standby electrical generating capacity or they could sell excess power back to the utility. This will greatly reduce capital costs and make the systems even more economically attractive. Existing facilities could tie-in and operate on utility power during periods of low demand or during emergencies and, if two way electrical transfers were available, sell electricity to the local utility when excess power is available. Even so, several plant managers at the eight facilities prefer to remain totally independent of the electric utility grid and its inherent problems.

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*"reasonable" tie-in rates for cogenerators are mandated in the National Energy Act.

Environmental Impact

Burning fuel can have a number of environmental impacts, including emission of combustion products to the air, discharges to the water, noise, and production of solid waste. The major potential environmental impact of cogeneration facilities, however, is the impact on air quality.

Since a cogeneration fcility operates more efficiently and burns less fuel than would be used in the separate generation of thermal and electrical energy, total emission of combustion products (CO, SOx, NOx, particulates, and photochemical oxidants) to the air can be reduced roughly in proportion to the fuel savings.** However, the cogenerator burns more fuel on-site than he would if he were providing heat only; and (2) the cogenerators may use a different technology or a different fuel than the boilers which are typically used for producing heat and generating electricity. Therefore, site specific calculations will be required to assure that environmental criteria are satisfied before deciding on cogeneration.

In New York City, gas is often the primary fuel for cogenerators. Due to the clean-burning nature of natural gas, the local air quality impacts of increased gas-fired cogeneration are minimized. The overall regional air quality impacts of increased gas-fired cogeneration are likely to be favorable since cogeneration will supplant primarily oil-fired generation of electricity at central power plants.

No environmental problems have been associated with the operation of the eight cogeneration facilities surveyed. The facilities easily obtained the required air emissions permits and have been operating in compliance with applicable air quality regulations.

All of these facilities are dual-fuel (gas and oil), and gas is the primary fuel at all but one, New York Telephone Company. Boiler and diesel operations are much cleaner and more easily controlled when gas is burned. Therefore, air

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**The air quality impacts of cogeneration are discussed in greater detail in "The Environmental Impact of On-Site Cogeneration," Fred C. Hart Associates, Inc., May, 1979.

quality impacts are minimized. For the foreseeable future, gas will be available to these facilities for 10 months of the year.

In addition, the majority of these facilities monitor the operation of their boilers and engines to insure high-efficiency operation. Smoke detectors are widely used during oil firing of burners and engines to identify the opacity of the plume. High opacity indicates the presence of particulates and soot in the plume resulting from incomplete combustion of the fuel. Temperature controls and monitors are also used to determine combustion efficiency in both gas- and oil-fired systems. A low operating temperature results in incomplete combustion. A high operating temperature results in burning more fuel than necessary, increasing all pollutant emissions, particularly NOx. These mesures and others (e.g., excess oxygen controls) are taken to maximize combustion efficiency, which in turn minimizes air quality impacts.

Potentially objectional emissions (primarily from a visual standpoint) may occur during start-up and soot blowing of oil-fired boilers and engines. However, such short-term emissions are permitted under current environmental regulations.

Economic Impact

Nearly all cogeneration units are installed with the expectation of dollar savings or profit. The dollar savings derive from the ability of cogeneration to create electricity on-site at a lower cost than purchased electricity. The lower cost of cogenerated electricity is due primarily to such factors as lower transmission costs and waste heat utilization, which result in higher system efficiencies than are obtainable at central power stations. Studies made in Europe and the United States all highlight the fact that cogeneration reduces electric bills by 40 to 60 percent.*

The economics are particularly advantageous in New York City due to the high cost of purchased electricity in

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*Louis M. Denis, "Cogeneration's Future: More Energy At Less Cost," *Energy User News*, Monday, November 27, 1978.

the region. Federal Energy Regulatory Commission data for 1978 estimate the rate for a typical industrial user in New York City at 7.2¢/kwh.**

Since electric power rates vary according to a number of factors including type of facility, peak demand, total demand, and load factor, some customers will pay slightly lower rates and others slightly higher rates than the 7.2¢/kwh average. Data indicate that the local electric power rates charged to large industrial, commercial and residential customers will range from approximately 6.4¢/kwh to 8.0¢/kwh.

Table 2 compares the cost of purchased electricity in New York City to cogenerated electricity at the eight cogeneration facilities and shows an estimated range of dollar savings per year based on these figures. The six facilities for which annual dollar savings estimates could be derived show annual savings of from $30,000 to $1,800,000. It should be noted that the highest annual savings estimated, the $1,800,000 at Rochdale Village, was derived from a detailed study of system operations and probably represents the most reliable estimate in Table 2. These figures are consistent with the 25-33 percent reduction in energy bills experienced by other New York City buildings which have retrofit cogeneration equipment.*

Conclusions

The results of the survey of eight cogeneration facilities in the Brooklyn Union Gas Company service area indicate that cogeneration does have a long and successful history of operation in the local area and is a viable option for a variety of facilities, including apartment complexes, shopping centers, office buildings, and industrial plants. The following conclusions can be drawn from the operating experience of the eight facilities in the area:

**This typical industrial user is one who consumes 200,000 kwh per month with a peak use of 500 kw.

*Ronald Smothers, "Private Businesses Turn to Making Their Own Energy", *Sunday New York Times*, April 15, 1979, p. A1.

1. *equipment operations have proved to be highly reliable over the 5-89 years the eight facilities have been in existence;*
2. *the frequency and duration of system outages is extremely low, particularly at the three apartment complexes and one commercial complex;*
3. *no environmental problems associated with the operation of the power plants have been encountered; and*
4. *the savings in dollars and fuel consumed (compared to purchasing electricity from the local utility and generating heat on-site) are substantial.*

In summation, th cogenerating power systems surveyed have a highly successful operating history, create no environmental problems and provide substantial economic benefits. These conclusions indicate that a large number of facilities in the New York City area could derive similar benefits. Recent trends toward (1) higher prices for purchased electricity, (2) greater availability of natural gas, (3) the enactment of legislative inducements such as tax credits, and (4) the establishment of reasonable rates for electric utility hook-up (as mandated by the National Energy Act) combine to further enhance the cogeneration option in New York City.

Supreme Court of the United States

No. 82-34

AMERICAN PAPER INSTITUTE, INC.,
PETITIONER,

v.

AMERICAN ELECTRIC POWER SERVICE CORPORATION, ET AL.

ORDER ALLOWING CERTIORARI. Filed October 12, 1982.

The petition herein for a writ of certiorari to the United States Court of Appeals for the District of Columbia Circuit is granted. The case is consolidated with case No. 82-226, *Federal Energy Regulatory Commission* v. *American Electric Power Service Corporation, et al.*, and a total of one hour is allotted for oral argument. Justice O'Connor took no part in the consideration or decision of this petition.

Supreme Court of the United States

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v.

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Nos. 82-226 and 82-34

IN THE

Supreme Court of the United States

OCTOBER TERM, 1982

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Respondents

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Respondents

On Petitions for Writs of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

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BRIEF OF RESPONDENTS IN OPPOSITION

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IN THE

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OCTOBER TERM, 1982

No. 82-226

FEDERAL ENERGY REGULATORY COMMISSION,
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On Petitions for Writs of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

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BRIEF OF RESPONDENTS IN OPPOSITION

STATEMENT OF THE CASE

This case originated as a challenge by three electric utilities (the "Electric Utilities")[1] to four rules promulgated by the Federal Energy Regulatory Commission (the "FERC" or the "Commission"). The Commission issued those rules pursuant to the portions of the Public Utility Regulatory Policies Act of 1978, Pub. L. No. 95-617 ("PURPA") which deal with cogeneration and small

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[1] The Electric Utilities are American Electric Power Service Corporation and Consolidated Edison Company of New York, Inc., two investor-owned utilities, and Colorado-Ute Electric Association, Inc., a cooperative system. The listing of all parent companies, subsidiaries (except wholly owned subsidiaries) and affiliates of each of the Electric Utilities required by Rule 28 is set forth in Appendix A.

power production.[2] Of the four rules challenged, the Court of Appeals vacated two and upheld two.

PURPA was part of a comprehensive legislative package designed to address the national energy crisis. As this Court noted in *FERC v. Mississippi*, —— U.S. ——, No. 80-1749, slip op. (June 1, 1982) at 2, Congress determined that conservation of oil and natural gas by electric utilities was essential to the success of any effort to achieve three goals: to lessen national dependence on foreign oil, to avoid a repetition of the shortage of natural gas that had occurred in 1977, and to control costs to the consumers of electric power. Because Congress believed that promotion of "qualifying" cogeneration and small power production would reduce the demand for oil and natural gas by electric utilities, and thereby promote these three goals, Congress enacted Sections 201 and 210 of PURPA, 16 U.S.C. §§ 796, 824a-3 (Supp. IV 1980). See *id.* at 6.

Section 201 amends Section 3 of the Federal Power Act (the "FPA") by adding definitions of "qualifying" cogeneration and small power production facilities. These definitions required the Commission to establish criteria, consistent with statutory standards, governing which cogeneration and small power production facilities would be eligible for the benefits conferred by Section 210 of PURPA.

Section 210(a) of PURPA directs the Commission to promulgate rules requiring electric utilities to offer to sell electric energy to, and to purchase electric energy from, qualifying facilities. Section 210(b) sets forth the standards which are to govern the rules promulgated by the FERC concerning the rates at which utilities are to purchase electric energy generated by qualifying facilities. Among these standards are the requirements that the rates for such purchases "shall be just and reasonable to

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[2] Two pertinent provisions of PURPA, Sections 201 and 210, were amended by Section 643 of the Energy Security Act, Pub. L. No. 96-294, 94 Stat. 611, 770 (June 30, 1980). The amendments are not relevant to any of the issues in this case.

the electric consumers of the electric utility and in the public interest. . . ." Under Section 210(f), the FERC's rules are then to be implemented by the states, which are to set rates for such purchases in accordance with those rules.

Section 210(e) of PURPA directs the Commission to promulgate rules pursuant to which qualifying facilities would be exempted, in whole or in part, from the FPA and certain other applicable state and federal laws and regulations. Section 210(e)(3) provides, however, that no qualifying facility may be exempted from the provisions of Sections 210 and 212 of the FPA, provisions which govern interconnections with utilities and which were added to the FPA by PURPA.

The four rules challenged by the Electric Utilities were:

(1) The "purchase rate rule," 18 C.F.R. § 292.304, Pet. App. B-111 to B-114,[3] which mandated that the states set rates for purchase of electric energy by a utility from qualifying facilities at a level equal to the utility's "full avoided" (or full incremental) cost. This rule would allocate all of the economic benefits of the transaction to the cogenerator and none to the consumers of the utility.

(2) The "interconnection rule," 18 C.F.R. § 292.303(c), Pet. App. B-110, which obligated electric utilities on a blanket basis to interconnect with qualifying facilities, exempting those facilities from the substantive and procedural requirements of Sections 210 and 212 of the FPA. By failing to apply those requirements to particularly sensitive interconnections, the Commission abandoned the federal interest in the reliability and integrity of the national network of electricity grids which the statute seeks to protect.

(3) The "simultaneous purchase and sale" or "simultaneous transaction rule," 18 C.F.R. § 292.304(b)(4), Pet. App. B-112, by which a utility is deemed,

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[3] "Pet. App." refers to the appendix to the petition for a writ of certiorari in No. 82-34.

at the cogenerator's option, to have purchased at full avoided cost all the electricity produced by the cogenerator, whether or not any of that power is made available to the utility.

(4) The definition of a "qualifying cogeneration facility," 18 C.F.R. §§ 292.203, 292.205, Pet. App. B-169 to B-172, which failed to include any fuel use test among the criteria governing qualifying status for oil- and gas-fired projects. In so doing, facilities which will increase the nation's use of oil and natural gas will receive the benefits of PURPA and will thereby be encouraged, contrary to the statute's basic purpose of reducing national dependence on these fuels.

A unanimous panel of the Court of Appeals for the District of Columbia Circuit, in an opinion by Judge Wilkey, vacated the purchase rate, or full avoided cost, rule and the interconnection rule; the court affirmed the simultaneous transaction rule and the Commission's failure to include a fuel use test in its definition of a "qualifying cogeneration facility."[4] On the Commission's petition for rehearing and suggestion for rehearing *en banc* concerning the full avoided cost and interconnection rules, the original panel of Chief Judge Robinson, and Judges Wilkey and Ginsburg unanimously voted to deny, while Judges Wald and Mikva voted to hear the case *en banc*.[5]

Both the FERC (Docket No. 82-226) and the American Paper Institute, Inc. ("API") (Docket No. 82-34), an intervenor in the court below, seek review by this Court of the decision vacating the full avoided cost and interconnection rules.[6] Since the questions they present and

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[4] Pet. App. B-1 to B-34.

[5] Pet. App. B-202 to B-208. Circuit Judges Wright, Tamm, MacKinnon, Robb, Edwards and Bork did not participate.

[6] API's effort to cast doubt on the jurisdiction of the Court of Appeals (which it first made to the court below on rehearing) to review those of the challenged rules issued under Section 210, rather than

the arguments they raise are essentially similar, the Electric Utilities hereby file a single opposition to the two petitions.

SUMMARY OF ARGUMENT

In enacting Title II of PURPA, Congress devised a carefully balanced program that sought to foster the development of cogeneration and small power production with the objective of saving oil and gas resources and as a means of moderating the rising costs of power to consumers. Congress provided, *inter alia*, that electric utilities should purchase surplus power from qualifying cogenerators (and small power producers) at rates that satisfy three specific criteria—the public interest, the interests of consumers of electric utilities and the interests of cogenerators.[7] However, in no event could those rates exceed the incremental cost to the utility of generating additional power (known as the full avoided cost). In particular, Congress specified that these rates be *the lower of* a "just and reasonable" rate and the full avoided cost.

In addition Congress authorized the FERC to order interconnections between, *inter alia*, qualifying facilities and electric utilities when the parties fail to agree on

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under Section 201, of PURPA because the former section is not an amendment to the Federal Power Act, is mistaken. (API Pet. 4, n.3). First, as the Commission found in its Order on Rehearing, Section 210 itself incorporates the judicial review provisions of the FPA, providing in Section 210(h) that for enforcement purposes, the FERC's rule herein "shall be treated as a rule under the Federal Power Act." Pet. App. B-177-78, n.2. Second, the rules issued under the two sections of PURPA are "interrelated" and "the issues will be more clearly delineated, and the task of separating interrelated sections will be obviated, if these rulemakings are subject to review in the same forum." FERC Order on Rehearing, Pet. App. B-178, n.2, citing *ECEE, Inc. v. FERC*, 611 F.2d 554, 564-65 (5th Cir. 1980).

[7] Cogenerators and small power producers which qualify for the benefits of PURPA are referred to herein both as "qualifying facilities" and, more generally, as "cogenerators."

the terms of such interconnection. This authority, Sections 210 and 212 of the FPA, specifies the criteria to be weighed, the procedures to be followed, and of key significance, the safeguards to electric utility consumers to be heeded in ordering such interconnections. Of prime importance is the provision of Section 212 that requires that the interconnection be designed so as not to impair the safety and reliability of the national network (or "grids") of electricity transmission.

Judge Wilkey, in a carefully balanced opinion joined by Judges Robinson and Ginsburg, considered four challenges to rules adopted by the FERC implementing the cogeneration and small power production provisions of PURPA. The court below upheld the Commission on two of the challenges. However, the Court of Appeals found that the Commission had disregarded statutory criteria in promulgating two aspects of those rules, and thereby had disregarded the limitations and requirements to which Congress directed that those rules must conform.

The Court of Appeals vacated the full avoided cost rule, which would direct all of the benefits of transactions between cogenerators and utilities to the qualifying facilities, leaving no opportunity for utility customers to share in those benefits.[8] As Judge Wilkey held:

> [Congress] specified the three other criteria [other than the limitation that rates never exceed full avoided cost]—in the 'public interest,' and the interests of cogenerators and 'electric consumers of electric utilit[ies]'—which the Commission was to consider in setting rates. It is apparent that the Commission did not do this, or at least if it did its rationale and process of consideration was never made explicit.

Pet. App. B-9.

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[8] The full avoided cost rule would cause rates for electricity to be higher than they would otherwise be. The higher the rates a utility pays to cogenerators, the higher will be the utility's costs, and hence the higher will be the rates it charges its customers.

The court therefore vacated the full avoided cost rule and remanded for further consideration. It did not say that on remand the Commission could not adopt a full avoided cost rule, but merely held that whatever rule it adopts, the FERC must explain how that rule fulfills the statutory criteria which prescribe the bounds of its rule-making power. Moreover, the Court did not invalidate the rule on the basis of any procedural infirmity or impose on the FERC any procedural requirements to be followed on remand.

The Court of Appeals also vacated the FERC's interconnection rule that would exempt qualifying facilities from the safeguards Congress enacted as part of PURPA to insure that the sensitive interconnections between these facilities and utilities would not threaten the safety, integrity and reliability of the national network of electricity grids. The FERC adopted this rule in spite of the express direction in Section 210(e)(3)(B) of PURPA that qualifying facilities not be exempted from these safeguards. Judge Wilkey's decision found "that this rule is inconsistent with the statutes." Pet. App. B-22.

The decision of the Court of Appeals vacating the interconnection and full avoided cost rules stands for the unassailable proposition that administrative agencies must confine their actions within the bounds set by Congress and that agencies must give a concise general statement of a rule's basis and purpose adequate to enable the courts to perform their task of judicial review. The decision conflicts with no decision of this Court, nor with the decision of any court of appeals. No novel legal question was raised before the Court of Appeals, and no novel legal question was decided by that court. Furthermore, the disposition by the Court of Appeals of both issues was legally correct.

Moreover, the decision of the Court of Appeals does not cast doubt on the FERC's ability to promulgate regula-

tions that would fully and effectively implement the statutory program. Nothing in that decision would frustrate the will of Congress. Quite the contrary, the Court of Appeals properly vacated the interconnection and full avoided cost rules precisely to insure that the program will proceed as it was envisioned by Congress. Review by this Court will needlessly exacerbate the delay in implementing the program (attributable to the illegality of the Commission's rules) of which the Petitioners complain. In short, this case provides no reason for this Court to exercise its review authority.

ARGUMENT

A. The Decision of the Court of Appeals Vacating the Full Avoided Cost Rule Was Correct, And Is Not Worthy of Review by This Court.

1. *The Review Exercised By the Court of Appeals Was a Limited and Wholly Appropriate Exercise of the Court's Review Function.*

The full avoided cost rule would deprive utility customers of all of the benefits of transactions with cogenerators and reserve every penny of those benefits to qualifying facilities. Petitioners seek to persuade that the Court of Appeals took some unusual action, resting on an unsound doctrinal basis, in vacating this rule. Examination of Judge Wilkey's opinion and of the opinion of the court below on rehearing discloses just the opposite. Not only did the Court of Appeals break no new ground, nor impose any unwarranted standard of review, but the court's review of the avoided cost rule was in fact a highly circumscribed holding well within the scope of judicial review of an agency's action which is claimed to conflict with a statutory mandate.

The FERC's petition avers that the Court of Appeals' "hostility to the full avoided cost rule appears to rest, at least in part, on the notion that the Commission lacks au-

thority to adopt such a rule, whatever justifying reasons it might proffer." (FERC Pet. 18). The Commission thereupon launches its attack on the decision as if the court below had in fact held a full avoided cost rule to be flatly illegal.

The Court of Appeals did no such thing. The court expressed its holding in clear and limited terms: "We hold that FERC has not adequately justified its adoption of the full avoided cost standard. Therefore the FERC rule is vacated and remanded to the Commission." Pet. App. B-9. Judge Wilkey's opinion could not be clearer that the holding below was no more than that the Commission had failed to provide an explanation for how a rule which *seems*, on its face, to conflict with the statute is "consistent with the statutory criteria." Pet. App. B-10. As the opinion explained in finding the Commission's conclusory defense facially inadequate, "The Commission may be right in its conclusion, but it needs to make its reasoning and findings explicit." Pet. App. B-11.

The Court of Appeals underscored the limited nature of its holding in its opinion on rehearing, stating that it "simply remanded the matter because the Commission had failed to explain 'its rationale and process of consideration.' " It characterized "the central point made by the court" as being "that FERC never bothered to present a cogent justification of its rule in light of the statutory instructions." Pet. App. B-203-04, citing the original opinion at Pet. App. B-9 to B-12. Even though the rule *appears* to conflict squarely with the statute's commands, the Court of Appeals expressly left open the possibility that the FERC could provide a justification of the full avoided cost rule that satisfies the statutory criteria.

In so doing, the Court of Appeals did not, as the FERC now charges, "substitute its judgment for that of the Commission." (FERC Pet. 21). Nor did it apply a "substantial evidence" test in reviewing the rule, as both

the FERC and API contend. The argument of these parties that the Court of Appeals engaged in an inappropriate judicial interference with agency action reflects a misunderstanding of what was before the court.

The issue for the Court of Appeals was whether the full avoided cost rule, as promulgated and justified by the FERC, is "consistent with the statutory criteria." Pet. App. B-10. As explained below, the standards which Congress enacted in Section 210 of PURPA require the Commission, *inter alia*, to balance the interests of qualifying facilities and utility customers in setting a purchase rate rule. By setting this rate in all cases at the maximum the statute permits in any case, the rule evades (or, at a minimum, appears on its face to evade) the statutory standards, the Congressional directive that the Commission balance the specified interests.

The question, then, is not whether the agency properly exercised its discretion, since no agency has discretion to ignore statutory commands. Instead, the question is one of statutory construction. This is a traditional judicial function to which such standards as "substantial evidence" and "arbitrary and capricious," by which the scope of review of an agency's exercise of discretion is described, are simply not pertinent.

These standards would be relevant to the question of the court's review function had the Commission explicitly balanced the interests of qualifying facilities and utility ratepayers as required by statute and had it adequately explained the rationale for its conclusions.[9] By refusing to permit electric utility customers to receive *any* of the benefits of purchase transactions, the Commission failed

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[9] The FERC could, for example, have demonstrated a balancing of interests by presumptively setting the purchase rate at 75% or 85% of avoided cost while leaving a cogenerator the freedom to establish that in its particular circumstance it warrants a greater share of the transaction's benefits (for example, where the cogenerator intends to rely on an innovative but inherently risky technology).

to consider whether rates would be "just and reasonable" to those customers and removed the issue on review from one of discretion to one of its adherence to statutory command. In reviewing that question, the Court of Appeals exercised circumspection and restraint, finding that the Commission appears not to have adhered to the statutory commands, but giving it the opportunity to adopt the same rule on remand if it can then "present a cogent justification of its rule in light of the statutory instructions." Pet. App. B-204.

Just how limited was the scope of the review engaged in by the Court of Appeals emerges clearly from consideration of the decision as a whole. In addition to vacating two of the Commission's rules, the court sustained the Commission on both the simultaneous transaction and fuel use issues. In so doing, Judge Wilkey's opinion deferred heavily to the Commission—sanctioning the Commission's right to attach extreme constructions to statutory terms.[10] When the decision below is read completely and carefully —both on the two issues raised by Petitioners and on the two issues with which they and the Court of Appeals are in agreement, it becomes clear that, contrary to Petitioners' suggestions, the court below engaged in a narrow, highly circumspect review of the Commission's actions.

The FERC asserts that the Court of Appeals "appears" to have relied on *Public Systems v. FERC*, 606 F.2d 973 (D.C. Cir. 1979), as authority for applying a "substantial evidence" standard. The court below applied no such

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[10] For example, the opinion upheld the Commission's construction, in support of the simultaneous transaction rule, that a "purchase" and "sale" between a cogenerator and a utility occurs where the cogenerator itself consumes all of the power which it generates. The court below also sustained the Commission's refusal to include fuel use criteria in the qualifications a facility must meet in order to be eligible for the benefits of PURPA—even though the effect of that refusal will be to increase the nation's use of oil and natural gas, directly contrary to the fundamental purpose of the statute.

standard. The erroneous notion that it did seems to be based on the reference of the dissenters on rehearing to the court's citation of *Public Systems* (at slip. op. 13) as "appear[ing] to assume" the application of the substantial evidence test. Pet. App. B-207, n.2. The dissenters misread Judge Wilkey's opinion, which made no mention of "substantial evidence" and cited *Public Systems*, in a footnote, for the quite different, and wholly unobjectionable, proposition that an agency has an "obligation to provide the public with the reasoned consideration, decisionmaking, and opinion which it is required to give." Pet. App. B-12. There is no dispute that an agency has such an obligation to engage in reasoned decisionmaking and to explain its actions adequately,[11] and the Court of Appeals remanded the full avoided cost rule because the FERC failed to discharge that particular obligation.

2. *The Decision of the Court of Appeals Is Correct.*

To be sure, the Court of Appeals seems to have had doubts that a full avoided cost rule could be squared with Section 210 of PURPA (although remaining open-minded and willing to give the Commission the opportunity to try to justify that rule). The court below acted correctly in vacating the rule, on the record below, as a brief examination of Section 210 shows.

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[11] *See, e.g., Citizens to Preserve Overton Park, Inc. v. Volpe*, 401 U.S. 402, 420 (1971); *Burlington Truck Lines, Inc. v. United States*, 371 U.S. 156, 167-168 (1962). The instant case is thus very different from *Vermont Yankee Nuclear Power Corp. v. NRDC, Inc.*, 435 U.S. 519 (1978). There, the court below had overturned a rulemaking on the ground that the procedures employed by the agency, though meeting all statutory requirements, were not those the court believed to be best suited to reaching a sound decision. This Court reversed the Court of Appeals as to that holding. In doing so, this Court did not restrict traditional judicial review of whether agency action comports with statutory commands. Indeed, this Court remanded the case back to the court below to determine whether the findings made by the agency were sustainable on the administrative record in that case. *Id.* at 549.

In Section 210, Congress directed the FERC to establish standards to guide state authorities as they in turn set rates at which utilities purchase power from qualifying facilities (so-called "purchase rates"). Those standards are that the rates not discriminate against qualifying facilities and be "just and reasonable to the electric consumers of the electric utility and in the public interest." In no event are these rates to exceed "the incremental cost to the electric utility of alternative electric energy." Section 210(b). It is this "incremental cost" maximum which the Commission's rules describe as "full avoided cost."

In the Conference Report on PURPA, Congress made clear that, as the Court of Appeals said (the emphasis being the court's), "section 210(b)'s incremental cost *limitation* is not to become a substitute for the 'just and reasonable' standard." Pet. App. B-9. As the Conference Report stated:

> [T]he utility would not be required to purchase electric energy from a qualifying cogeneration or small power production facility at a rate which exceeds *the lower of* the rate described above, namely a rate which is just and reasonable to consumers of the utility, in the public interest, and nondiscriminatory, or the incremental cost of alternate electric energy. This limitation on the rates which may be required in purchasing from a cogenerator or small power producer is meant to act as an *upper limit* on the price at which utilities can be required under this section to purchase electric energy.[12]

As the Court of Appeals explained, the standards which Section 210 sets for the Commission's purchase rate rules direct the Commission to balance the interests of qualifying facilities, utility consumers and the public. "Congress made a clear distinction between a 'just and

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[12] (Emphasis supplied). Conference Report on the Public Utility Regulatory Policies Act, H.R. Conf. Rep. No. 1750, 95th Cong., 2d Sess. at 98 (1978), quoted by the court, Pet. App. B-9 to B-10.

reasonable' rate and a rate based on the full avoided cost, though the two *may* coincide." (emphasis in the original). Pet. App. B-10. As the court put it:

> Congress could have required the Commission to set rates at full avoided cost. Congress did not do so. Instead, it specified the three other criteria—the "public interest," and the interests of cogenerators and "electric consumers of electric utilit[ies]"—which the Commission was to consider in setting rates.

Pet. App. B-9.

The full avoided cost rule directs, as a rule, that *all* benefits of purchase transactions be given to cogenerators, and that *none* thereby be provided to utility consumers. Such a rule provides none of the balancing of interests and sharing of benefits with consumers which the statutory criteria require. The just and reasonable and full avoided cost standards are different, and the Commission cannot automatically equate them in all cases—at least not without a far more cogent explanation than is presented by this record. As the Court of Appeals said, "It is apparent that the Commission did not do this [consider the statute's criteria, including the 'just and reasonable' standard], or at least if it did its rationale and process of consideration were never made explicit. Instead the Commission came to the simplistic and uninformed conclusion that the full avoided cost standard would be just and reasonable in every case and that this was necessary to encourage cogeneration in every case." Pet. App. B-9.

Petitioners' only defense of the merits of the rule lies in their claim that Judge Wilkey's opinion errs because the full avoided cost rule falls within, or at the outer edge of, what is claimed to be "the congressionally established zone of reasonableness." (FERC Pet. 18-19). The flaw in this argument is that Congress did not equate the full avoided cost limitation with rates that are within a zone of reasonableness. Rather, it wrote a statute that clearly contemplates that full avoided cost will at times

exceed what is "just and reasonable" to utility consumers, and that the lower of the two is then to apply.[13]

Petitioners' mistake the "full avoided cost" limitation in Section 210(b) with a Congressionally established zone of reasonableness. However, the notion of such a zone derives not from the full avoided cost limitation, but rather from the just and reasonable standard itself.[14] As the Court of Appeals stated, "It has long been held that the essence of the just and reasonable standard is a balancing of the interests of the affected parties." Pet. App. B-10. What Congress did in enacting the "just and reasonable" and other standards of Section 210(b) was to direct the Commission to the criteria it was to employ—that is, to the factors to be balanced—in deciding where within the zone of reasonableness purchase rates should fall.

Congress did not establish the numerical locus of that zone, and so far neither has the Commission. What that zone is to be for purchase rates cannot be determined until the Commission engages in the balancing which the just and reasonable standard requires. The Commission cannot excuse its failure, as the court below said, "to consider the hard questions which the standard necessarily raises," Pet. App. B-10, by relying on one standard (the requirement that in no event are rates to exceed full avoided cost) to write out of PURPA another separate and distinct standard (that rates be just and reasonable to the electric consumers of the electric utility).[15]

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[13] *See* Conference Report, p. 98, quoted at p. 13, *supra*.

[14] *See FPC v. Hope Natural Gas Co.*, 320 U.S. 591, 603 (1944).

[15] *See American Textile Manufacturers' Institute v. Donovan*, 452 U.S. 490, 512-13 (1981). Petitioners' citation to the *Permian Basin Area Rate Cases*, 390 U.S. 747 (1968), is inapposite since those cases involved review of whether or not a rate resulting from a particular balance of interests by the Commission was reasonable,

The FERC attempts to save the rule by supplying a new rationale, at this late date. That new rationale is that, despite the rule, some actual rates may be below full avoided cost. Not only is this effort of counsel to supply post-hoc rationalizations insufficient to rehabilitate agency action which was defective when taken,[16] but it is wholly unpersuasive.

The FERC cites three circumstances in which, it now claims, the harshness of the full avoided cost rule may be mitigated. The first is if a state commission were to ask the FERC to waive the rule; but, this is little comfort to a utility and its customers since they cannot even initiate this extraordinary, discretionary review. The second is if the parties were to negotiate rates below full avoided cost. That parties may voluntarily agree to forego their rights under a rule mandating payment of full avoided cost is not a defense of that rule when the statute requires that the rule adhere to a "just and reasonable" standard. In any event, that a cogenerator may accept less than its due under the rule offers limited practical benefit, since it remains free to demand what the rule provides.

The third claim is that there are "significant long-term economic savings to consumers and to the national interest in reducing dependence on imported oil." (FERC Pet. 20).[17] To the contrary, the Commission's own petition

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while this case involved review of a Commission rule which ignored the "hard questions" and failed to strike any balance at all.

[16] *See American Textile Mfrs. Institute, Inc. v. Donovan*, 452 U.S. 490, 539 (1981).

[17] The Commission's claim that its rules will reduce national dependence on imported oil is ironic. The Electric Utilities unsuccessfully argued to the Court of Appeals that the Commission erred in refusing to include fuel use criteria in the definition of qualifying oil- and gas-fired cogeneration facilities and in failing to permit the states to take fuel use factors into account in setting purchase

recognizes that there will not, in fact, be any such economic savings. Its own explanation of the rule (quoted at FERC Pet. 21) explains that "use of the full avoided cost standard will not produce any rate savings to the utility's customers." (FERC Pet. 7). Thus, the FERC's new argument asserts the existence of potential benefits to utility customers which are nonexistent, ephemeral and irrelevant.[18]

3. *The Effects of the Court of Appeals' Decision Are Sound, and Not Adverse.*

One of Congress' purposes in enacting Section 210 of PURPA was to provide consumers with a share of the benefits of purchase transactions between cogenerators and utilities. As cost escalations have driven utility rates up, such a sharing of benefits is sound policy. In challenging the full avoided cost rule, utilities are acting on

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rates for oil- and gas-fired qualifying facilities. Whether the court below was correct or incorrect to sustain the Commission's summary disposition of the fuel use issue, the interrelated effects of that disposition with the full avoided cost rule are clear. The full avoided cost rule exacerbates the adverse effects of the Commission's failure to include fuel use provisions in its rules since it requires that all oil- or gas-fired facilities, many of which will increase the nation's use of these fuels, be paid a purchase rate at full avoided cost.

[18] Further, the FERC's argument ignores the direct and concrete harms that the rule will cause in many circumstances—which were noted by the Court of Appeals. Pet. App. B-12 to B-13. The effects of the full avoided cost rule on utility consumers are also exacerbated by the "simultaneous transaction" rule, the legality of which the Electric Utilities unsuccessfully challenged before the Court of Appeals. That rule requires the utility to pay the cogenerator for the power that it generates and consumes for itself (at full avoided, or incremental, cost) while the cogenerator pays the utility its regular rate (based on embedded rather than incremental costs) for that same power. The result is, in essence, a cash payment from the utility to the cogenerator for power which the utility does not receive.

behalf of their customers, for it is their customers and not their shareholders who will reap the benefits of lower rates should the purchase rate rule be set at something below full avoided cost. The economic dispute over the full avoided cost rule is, therefore, between cogenerators and small power producers on the one hand and, on the other, utility consumers who lack the resources or opportunity to construct qualifying facilities. Most of the anticipated cogeneration capacity will be owned by large industrial companies, such as API's members.

The Petitioners suggest that any rate below full avoided cost will be insufficient to induce the construction of worthy cogeneration and small power production projects.[19] The Court of Appeals effectively disposed of this unsupported claim: "Thus, the Commission holds that the bare, unquantified possibility that a rule permitting rates at less than full cost *might* be insufficient to encourage the last kilowatt hour of cogeneration justified shutting the utility's customers out of any share of the benefits. But this seems entirely inconsistent with the clear intent of Section 210(b), which seeks to strike a balance among the interests of cogenerators, 'electric consumers of electric utilit[ies],' and the 'public interest.'" Pet. App. B-12. (Emphasis in the original.)

The FERC claims that it will be no better able to justify a rule below full avoided cost than a rule at that 100% level. This claim is wholly incorrect, and results from the Commission's misunderstanding of the full avoided cost issue. The Court of Appeals was not reviewing an exercise of the Commission's discretion, but rather an act that seems to violate the statute. The Court of

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[19] However, a purchase rate rule not *requiring* payment of full avoided cost can *permit* such a payment in a particular case in which a state finds that such a rate is needed to induce construction of a beneficial project.

Appeals rejected the Commission's justification of the rule because the rule *appears* to conflict on its face with the statute and because the Commission "never bothered to present a cogent justification of its rule *in light of the statutory instructions.*" (Emphasis supplied.) Op. denying rehearing, Pet. App. B-204.

Should the Commission adopt a rule that provides a sharing of benefits (*i.e.*, a rule not requiring purchase rates to equal full avoided cost), the review by any appellate court will necessarily be different, and less inquisitive, than in the instant case. For, with such a rule that provides a balancing of interests, the question will not be whether the Commission strayed from the statutory framework. Rather, the question will be whether its judgment, say, to set the rate at 75% or 85% of avoided cost will have been an appropriate exercise of its discretion within the statutory framework. In fact, the Court of Appeals encouraged the Commission to consider basing purchase rates on a percentage of avoided cost, thereby providing the balancing contemplated by the statute. Pet. App. B-12. There is nothing in the opinion below that should give the Commission difficulty in promulgating a rule providing a meaningful sharing of benefits that survives judicial review.[20]

Both the FERC and API would have this Court exercise its review authority to remove uncertainties and delays resulting from the present litigation. The Electric Utilities have only sought to require the Commission to

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[20] The difficulty which the Commission fears it might have in supporting itself on remand is confined to any future effort by the Commission to justify the full avoided cost rule, and has no application to defending a balanced rule. The Commission's concern focuses on the discussion by the Court of Appeals at Pet. App. B-12 to B-16 (FERC Pet. 21). However, the Court expressly confined the discussion at these pages (which are dicta) to what it described at the beginning of that discussion as "some additional concerns raised *by the full avoided cost rule.*" (emphasis supplied) Pet. App. B-12.

enforce the law that Congress enacted. Any uncertainty and delay is unfortunate, but they are the result of the Commission's failure to promulgate a lawful rule in a timely manner. This circumstance is only temporary, and the sooner the Commission gets on with adopting a lawful rule, the sooner the cogeneration program will be fully operating in the manner Congress specified.

B. The Decision of the Court of Appeals Vacating the Interconnection Rule Was Correct, And Is Not Worthy of Review by This Court.

1. *The Rule Adopted by the FERC Cannot Be Squared With the Plain Language of the Statute.*

Sections 202 and 204 of PURPA added Sections 210 and 212 to the FPA, 16 U.S.C. §§ 824i, 824k (Supp. IV 1980). FPA Sections 210 and 212 contain procedural and substantive safeguards governing interconnections which are described in FPA Section 210(a)(1) thus:

> Upon *application of any* electric utility, Federal power marketing agency, *qualifying cogenerator, or qualifying small power producer*, the Commission may issue an order requiring—
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> (A) the physical connection of any cogeneration facility, any small power production facility, or the transmission facilities of any electric utility, with the facilities of any such applicant. . . . (emphasis supplied).

FPA Section 210 thus expressly encompasses interconnections between qualifying facilities and utilities.

Section 210(e)(3)(B) of PURPA states:

> No qualifying small power production facility or qualifying cogeneration facility may be exempted under this subsection from—
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> . . . .
>
> (B) the provisions of section 210, 211 or 212 of the Federal Power Act. . . .

Against this statutory background, FERC promulgated rule 292.303(c)(1), which directs utilities to "make such interconnections with any qualifying facility as may be necessary to accomplish purchases or sales under this subpart," exempting such facilities from the need to comply with the safeguards specified in FPA Sections 210 and 212. As the Court of Appeals found, "this rule is inconsistent with the statutes." Pet. App. B-22.

The Commission claimed to the Court of Appeals that it should have authority to order interconnections without compliance with the FPA sections. Judge Wilkey dealt with its first argument thus: "FERC argues that compliance with the literal meaning of the statutory sections would impose undue burdens upon cogenerators. However, the Commission need not impose substantial administrative burdens on those facilities, but rather can adopt streamlined procedures." Pet. App. B-23. As is discussed below, the Commission's argument that compliance with the statute will "impose undue burdens" is mistaken.[21]

The Commission then argued that it has authority, independent of FPA Sections 210 and 212, to order interconnection without compliance with those sections. The FERC seeks to imply this authority, which is not expressed in any statute, from Section 210(a) of PURPA. That section authorizes the FERC to promulgate rules relating to the *rates* utilities are to pay to cogenerators, which rules are to encourage cogeneration and small power production. By its express terms Section 210(a) of PURPA is limited to the Commission's *rate* rules; it implies no authority with respect to interconnections. In any event, even if such implied authority existed, it would not override the express limitation in Section 210(e)(3)(B) precluding the exemption of qualifying facilities

[21] The issue is not whether interconnections between qualifying facilities and utilities generally will occur—they will—but rather whether the Commission can blanketly exempt them from statutory requirements when PURPA Section 210(e)(3) expressly precludes that exemption.

from the FPA sections. Judge Wilkey rejected this effort to use what is at most a "relatively *general grant* of authority" to overcome the "relatively *specific limitation* on authority" in PURPA Section 210(e)(3)(B), holding that the general directive "does not give the Commission a mandate to consign detailed provisions of PURPA itself to the wastebasket as meaningless surplusage." Pet. App. B-24 (emphasis is the court's).[22]

The Commission then sought to justify its disregard of FPA Sections 210 and 212 by interpreting Section 210(e)(3)(B) of PURPA as restricting its authority to waive the requirements of FPA Sections 210 and 212 only when qualifying facilities are "targets" of, and not applicants for, interconnection orders.[23] The Court of Appeals found this distinction between "applicants" and "targets" bereft of support in the statute or its history and "both counterintuitive and inconsistent with the statute's explicit provisions." Pet. App. B-24 to B-25.

The Commission has never been able to explain how this distinction is pertinent to or discernible within the statute. It argues that there is a meaningful distinction between (i) the "burden" upon qualifying facilities of being targets of interconnection orders and (ii) the "benefits" whether to utilities or qualifying facilities of being able to apply for such orders. (FERC Pet. 14-15). That argument would engraft a confusing limitation on an otherwise directly phrased statute. The "burdens" and "benefits" contained in the FPA sections are inextricably

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[22] The Commission's statement of the question presented suggests that the Court of Appeals' reading of the statute requires "case-by-case evidentiary adjudications" before any interconnection can be compelled (FERC Pet. I). However, the court specified no particular procedures, whether "case-by-case evidentiary adjudications" or otherwise; and, as discussed in Part B-3, *infra*, evidentiary adjudication will in fact be required infrequently.

[23] A qualifying facility would be an unwilling "target" of an interconnection application only in the unlikely case in which a utility wanted to force it to sell power to the utility against the will of the qualifying facility.

intertwined, in that an applicant seeking interconnection can obtain that benefit only by satisfying the supposedly burdensome requirements. The artificial nature of the "burden"—"benefit" distinction is underscored by Petitioners' own argument, in which they claim that the consequence of qualifying facilities' not being exempted from what they see as the "benefit" side of the issue (being able to interconnect) is that they will thereby endure what they claim will be great procedural "burdens." Furthermore, the distinction is inherently artificial when applied to a statute referring to application for interconnection orders by both utilities and qualifying facilities since one person's benefit is often another's burden.

In fact, the statutory language is clear and simple to parse. Section 210(e)(3)(B) of PURPA precludes the exemption of qualifying facilities from Sections 210 and 212 of the FPA without qualification or distinction. And, FPA Section 210(a)(1) expressly includes qualifying facilities as applicants for interconnection orders. Had Congress wanted to limit the section's reach to qualifying facilities as targets only, it could easily have excluded them from the class of applicants. (Congress made the converse of this distinction in its treatment of Federal power marketing agencies, authorizing these agencies to apply for interconnection orders but protecting them from being posssible targets of such orders by excluding them from the list of entities in Section 210(a)(1)(A) against whom such orders could be applied.)

The Commission claims that the complexity of the statute "should have given the court of appeals pause before it substituted its own construction for that of the agency" (FERC Pet., p.16, n.11); and, API argues that the court below should have given deference to the FERC's construction. These suggestions amount to an argument that the Court of Appeals should have let stand a mistaken construction of the statute. However, as this Court has noted,

> the courts are the final authorities on issues of statutory construction, . . . and "are not obliged to stand aside and rubber-stamp their affirmance of administrative decisions that they deem inconsistent with a statutory mandate or that frustrate the congressional policy underlying a statute." . . . "The deference owed to an expert tribunal cannot be allowed to slip into a judicial inertia. . . ." (citations omitted).

Volkswagenwerk Aktiengesellschaft v. Federal Maritime Commission, 390 U.S. 261, 272 (1968).[24]

The Court of Appeals concluded that the rule contradicts the plain language of the statute. In this circumstance it was obliged, under the decisions of this Court, to vacate the rule.[25] As this Court stated in *Consumer Product Safety Commission v. GTE Sylvania*, 447 U.S. 102, 108 (1980): "Absent a clearly expressed legislative intention to the contrary, that language must ordinarily be regarded as conclusive."

2. *The Legislative History Confirms That the Intent of Congress is Consistent With the Plain Meaning of the Statute.*

The legislative history supports the plain meaning of the statute as construed by the Court of Appeals.

As initially passed by the House and the Senate, the statutory language would have directed the Commission to include in its regulations implementing what became Section 210 of PURPA "rules respecting the interconnection of a qualifying cogeneration facility to the distribu-

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[24] *See also United States v. Vogel Fertilizer Co.*, —— U.S. ——, 102 S. Ct. 821, 827 (1982); *Rowan Companies, Inc. v. United States*, 452 U.S. 247, 253 (1981), *quoting National Muffler Dealers Association, Inc. v. United States*, 440 U.S. 472, 477 (1979).

[25] *International Brotherhood of Teamsters v. Daniel*, 439 U.S. 551, 566 n.20 (1979).

tion system of any electric utility. . . ." H.R. 8444, § 546(a)(2)[26]; H.R. 4018, § 246(a)(2).[27] The Conference Committee made two deliberate and crucial modifications. On the one hand it eliminated the legislative language which would have made interconnection one of the subjects of the Commission's regulations under PURPA Section 210; and on the other hand, it added Section 210(e), with its express prohibition against exempting qualifying facilities from, *inter alia*, Sections 210 and 212 of the FPA. By adding the non-exemption provision at the same time that it eliminated interconnection as a subject for the Commission's rules under PURPA Section 210, Congress demonstrated its intent to apply the procedural and substantive requirements of the FPA interconnection provisions to qualifying facilities that seek the benefit of interconnections.

While the Commission notes that *one* Congressional purpose in enacting FPA Section 210 was to fill a statutory gap respecting certain intrastate utilities (FERC Pet. 12-13), it does not claim that this was Congress' *only* purpose in enacting that section. The plain language of the carefully crafted statute, and its history, demonstrate the intent of Congress to further a second purpose: to establish requirements pertinent to interconnections between qualifying facilities and utilities that would insure maintenance of the safety and reliability of service to electric utility customers.[28]

3. *The Commission's Rule Fails to Give Full Effect to Congress' Purposes and Is Not Necessary to Avoid Frustration of Any Congressional Goal.*

Both the FERC and API argue that the Court of Appeals' interconnection holding "defeats the basic goal of

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[26] 95th Cong., 1st Sess. (1977).

[27] 95th Cong., 1st Sess. (1977).

[28] Had Congress only intended to fill the intrastate utility gap, it could easily have limited FPA Section 210(a) so that it did not apply explicitly to the interconnections at issue in this case.

Section 210 of PURPA." (FERC Pet. 12; API Pet. 8). As they see it, to enforce the plain meaning of the statute would so burden qualifying facilities as to discourage the cogeneration and small power production that Congress sought to promote. This argument is mistaken for two reasons: it ignores the powerful federal interest in assuring that interconnections be safe and reliable, and it constructs a false parade of horrors that makes the enforcement of the statute seem onerous when it should, in fact, be simple and unburdensome.

Congress enacted the cogeneration and small power production provisions of PURPA not as an end in itself, but to further a series of specified purposes,[29] among which was to improve the reliability of electric service. PURPA Section 2(2); *see* PURPA Section 204 (FPA Section 212(a)). Interconnections by which qualifying facilities transmit power into electricity grids are far more technically complex and sensitive than are typical customer interconnections which are only intended to enable the delivery of power from utilities to their customers. As such, the interconnections to permit qualifying facilities to transmit power to utilities *can* have a substantial adverse effect upon the reliability, integrity and safety of the highly complex network of electricity grids—leading, for example, to interruptions of service.

Protecting that interstate, indeed international, network was a federal responsibility prior to the enactment of PURPA. PURPA shares *rate* authority over wholesale sales from qualifying facilities to utilities between the FERC and the states; however, it also represents a clear congressional intent to preserve the pre-existing federal role over such interconnections.[30]

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[29] See, *e.g.*, the Statement of the Case, p. 2, *supra*.

[30] As Judge Wilkey put the matter, "FERC's argument extolling the wisdom and popularity of its interpretation [that sections 210

Petitioners would have the FERC abdicate this federal responsibility and ignore the statutory provisions governing interconnections out of a belief that to enforce FPA Sections 210 and 212 would subject qualifying facilities to onerous burdens.[31] These supposed burdens arise out of FPA Section 210(b)(2)'s direction that the Commission "afford an opportunity for an evidentiary hearing." But, Petitioners are wrong to suggest that enforcing the law might require "years of litigation to establish an interconnection" (FERC Pet. 17), for the necessary procedures can and should be simple and expeditious and only rarely require a hearing.

The Court of Appeals stated that the "Commission need not impose substantial administrative burdens on [qualifying] facilities, but rather can adopt streamlined procedures." Pet. App. B-23. Indeed, even where evidentiary hearings are required, the FERC can reasonably simplify them to a substantial degree—for example, by narrowing the issues to actual disputes of fact, by strictly confining

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and 212 of the FPA do not apply] is necessarily unavailing when Congress has explicitly chosen a policy to the contrary." Pet. App. B-23.

[31] The FERC's petition avers that enforcing these sections would subject qualifying facilities "to the very type of public utility regulation from which Congress sought to insulate them," citing the Conference Report to this effect. (FERC Pet. 16). But the language of the Conference Report which the FERC quotes (at footnote 13 at p. 16 of its Petition) does not apply to procedures to protect the national electricity grid with respect to interconnections at all; rather, the Conference Report confined that discussion of regulatory burden to the matter of *rates*, saying that "the examination *of the level of rates* which should apply to the purchase by the utility of the cogenerator's or small power producer's power should not be burdened by the same examination as are *utility rate applications*, but rather in a less burdensome manner." (emphasis supplied).

the parties to what is relevant and by commanding expedition.[32]

However, there is no reason why there should, or need, be *any* hearing in the case of the vast majority of interconnections. The statute only requires the Commission to "afford an opportunity" for a hearing.[33] This does not mandate a hearing in any case in which one is sought. Rather, as numerous decisions of this Court establish, an agency may restrict the opportunity for a hearing to those cases in which a party satisfies threshold requirements established by the agency. *See Costle v. Pacific Legal Foundation*, 445 U.S. 198, 213-15 (1980); *Weinberger v. Hynson, Westcott & Dunning*, 412 U.S. 609, 620-21 (1973); *FPC v. Texaco*, 377 U.S. 33, 39 (1964); and *United States v. Storer Broadcasting Co.*, 351 U.S. 192, 205 (1956).[34] There is nothing to prevent the FERC from limiting hearings to those relatively few situations in which there are genuinely disputed issues of fact material to determining whether an interconnection would satisfy the standards Congress set in FPA Sections 210 and 212.

Thus, the interpretation of the Court of Appeals does not "paralyze with one hand what [Congress] sought to promote with the other." *Clark v. Uebersee Finanz-*

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[32] Nor is the fear that a party might abuse procedures, API Pet. 9, a reason to eliminate them—especially since both the FERC and state utility commissions have adequate means to dissuade any utility suspected of such abuse.

[33] FPA § 210(b)(2).

[34] That the APA applies when a hearing must be held does not in any way restrict the FERC's right to limit the availability of a hearing to those cases in which there are *material* facts in dispute. Moreover, the determination by the agency whether there are such material facts in dispute is not subject to the substantial evidence test on review. *Weinberger v. Hynson, Westcott & Dunning*, 412 U.S. 609, 622 n.19.

Korp., 332 U.S. 480, 489 (1947).[35] Rather, it properly construes the statute, to give full effect to the integrated and comprehensive statutory scheme enacted in PURPA, including PURPA Sections 202, 204 (FPA Sections 210 and 212) and 210. And, it does so without raising any important issues of doctrine or policy that warrant review by this Court.

CONCLUSION

For the reasons set forth herein, the petitions of the FERC and API for a writ of certiorari should be denied.

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[35] A court is to look behind the facial meaning of a statute only in extraordinary circumstances, as when the facial meaning is "fundamentally at odds with the manifest congressional design." *United States v. Vogel Fertilizer Co.*, —— U.S. ——, 102 S. Ct. 821, 828 (1982). As the text discloses, there is no such conflict between the words of the statute and the congressional design. Should future experience with the procedures of FPA Sections 210 and 212 disclose burdens that are now not reasonably anticipated, the remedy will then be for the Congress.

APPENDIX A

Pursuant to Rule 28, the following is a list of all parent companies, subsidiaries (except wholly owned subsidiaries) and affiliates of each of the Respondent Electric Utilities.

1. Respondent American Electric Power Service Corporation is a wholly owned subsidiary of American Electric Power Company, the affiliates and subsidiaries (except wholly owned) of which are:

Appalachian Power Company
Beech Bottom Power Company
Cardinal Operating Company
Columbus and Southern Ohio Electric Company
Indiana and Michigan Electric Company
Indiana Kentucky Electric Corp.
Ohio Power Company
Ohio Valley Electric Corp.

2. Respondent Consolidated Edison Company of New York, Inc.'s affiliates and subsidiaries (except wholly owned) are:

Honeoye Storage Company

3. Respondent Colorado-Ute Electric Association, Inc. is an association of rural electric cooperatives. The following cooperatives are members of the association:

Delta-Montrose Electric Association
Empire Electric Association, Inc.
Grand Valley Rural Power Lines, Inc.
Gunnison County Electric Association, Inc.
Holy Cross Electric Association, Inc.
Intermountain Rural Electric Association
LaPlata Electric Association, Inc.
Sangre De Cristo Electric Association, Inc.
San Isabel Electric Association, Inc.

San Miguel Power Association
San Luis Valley Rural Electric Cooperative, Inc.
Southeast Colorado Power Association
White River Electric Association, Inc.
Yampa Valley Electric Association, Inc.

Colorado-Ute Electric Association, Inc. has no other affiliates or subsidiaries (except wholly owned).

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No. 82-34

IN THE

Supreme Court of the United States

OCTOBER TERM, 1981

AMERICAN PAPER INSTITUTE, INC.,
Petitioner,

v.

AMERICAN ELECTRIC POWER SERVICE CORPORATION, CONSOLIDATED EDISON COMPANY OF NEW YORK, INC., COLORADO-UTE ELECTRIC ASSOCIATION, INC., FEDERAL ENERGY REGULATORY COMMISSION, *et al.*,
Respondents.

On Petition For Writ Of Certiorari To The United States Court Of Appeals For The District Of Columbia Circuit

BRIEF FOR RESPONDENT ELIZABETHTOWN GAS COMPANY IN SUPPORT OF PETITION

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No. 82-34

AMERICAN PAPER INSTITUTE, INC.,

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v.

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Respondents.

On Petition For Writ Of Certiorari To The United States Court Of Appeals For The District Of Columbia Circuit

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BRIEF FOR RESPONDENT ELIZABETHTOWN GAS COMPANY IN SUPPORT OF PETITION

Elizabethtown Gas Company (Elizabethtown), intervenor in the court below and, therefore, a party herein (Rule 19.6), urges this Court to grant the petition for writ of certiorari.

STATEMENT

Elizabethtown is a public utility organized and existing under the laws of the State of New Jersey.[1] Under regulation by the New Jersey Board of Public Utilities, Elizabethtown engages in the sale and distribution of gas in 68 municipalities serving over 190,000 customers. Elizabethtown competes in its service area with electric utilities supplying the energy needs of residential, commercial and industrial end users.

Elizabethtown is an actual supplier of gas to cogeneration facilities and a potential supplier of gas to cogeneration facilities which could qualify for the benefits of the Public Utility Regulatory Policies Act of 1978 ("PURPA"), Pub. L. No. 95-617, 92 Stat. 3117.[2]

The petition for writ of certiorari challenges the decision of the court below insofar as it vacated two of the rules set out in Commission Order No. 69 which im-

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[1] Elizabethtown is a subsidiary of National Utilities and Industries Corporation and has as affiliates Achter Kol Corporation, National Computer Utility Company, Computer Utility Company, NUI Corporation, Enercorp Resources Inc., Enercorp, Nexco Inc., Utility Propane Company, National Gas Gathering Company, National Energy Leasing Company, National Enerdrill Corporation, and The Lenape Resources Corporation.

[2] The relevant provisions of PURPA are reproduced on appendix pages A-7 to A-16 to the petition for writ of certiorari. Section 201 of PURPA required the Federal Energy Regulatory Commission to establish criteria under which cogeneration and small power production facilities could qualify for PURPA benefits. The Commission's Order No. 70, as amended, setting forth those criteria is not the subject of the petition for writ of certiorari. The text of Order No. 70 is reproduced on appendix pages B-120 to B-174 to the petition.

plemented Section 210 of PURPA,[3] namely the "full avoided cost" standard for the sale of surplus power from qualifying facilities to electric utilities, and the interconnection rule requiring electric utilities to interconnect with qualifying facilities.

Elizabethtown accepts, for purposes of this pleading, Petitioner's statement of questions presented, list of parties to the proceeding below, statement of opinions below, statement of jurisdiction, list of statutory and regulatory provisions involved, and statement of the case.

SUPPLEMENTAL REASONS FOR GRANTING THE WRIT

1. Elizabethtown hereby supports and supplements Petitioner's reasons for granting the writ.

2. The installation of fuel-efficient cogeneration facilities has been stultified because of the lack of assured interconnections with electric utilities which might serve as a market for surplus electric power, and a pricing mechanism for surplus power which would facilitiate the economic planning of new cogeneration facilities.[4]

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[3] Section 210 directed the Commission to prescribe rules which it deemed necessary to establish relationships between qualifying facilities and electric utilities "to encourage cogeneration and small power production." 16 U.S.C. § 824a-3(a). Order No. 69, as amended, is reproduced on appendix pages B-104 to B-119; B-167 to B-174 to the petition.

[4] Opportunities to develop these sources of electric power outside the electric utility industry existed, but were found to be inhibited by the lack of access to interconnections with electric utilities caused by

> uncertainty as to the extent to which the energy cost savings could be offset by higher rates for supplemental or back-up power,

Natural gas is used as a fuel in cogeneration facilities. Where air pollution is a problem, natural gas is a preferred fuel. Gas distribution companies indicated during the rulemaking process that they sought to be a competitive source of energy to fuel PURPA-induced cogeneration.[5]

It is more efficient to use natural gas as a fuel in a cogeneration unit than to use natural gas as a fuel in a typical public utility electric power generation plant. This is because the steam utilized in the latter plant is condensed after passing through the electricity-generating turbines instead of being put to some other industrial or commercial use. In this regard, the Commission found: "Cogeneration facilities use significantly less fuel to produce electricity and steam (or other forms of energy) than would be needed to produce the two separately."[6]

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uncertainty as to their ability to sell surplus power to the utility at a price which reflects its market value, and

reluctance to invest in generation facilities (however economic they may be) if this would bring them under public utility regulation.

See pages B-29 and B-121 of appendix to petition.

[5] About 25 percent of the PURPA-induced cogeneration in the industrial sector is expected to be installed in the Middle Atlantic area which includes New Jersey. The chemical industry anticipates using natural gas in gas-fired combustion turbines and, with process-derived fuels, in steam-topping cycle engines. Pulp and paper plants would use gas and oil as a fuel for cogeneration to augment wood and other process by-products.

PURPA-induced commercial cogeneration is expected to occur almost exclusively in the Middle Atlantic area and to take the form primarily of diesel engines and dual-fuel use engines. Natural gas would be used in dual-fuel use engines when available and less expensive than diesel fuel.

[6] See appendix page B-39 to petition.

3. The cogeneration rules were intended to provide competitive cogeneration sources for bulk electric power. The Commission found: "By obtaining electric energy from cogeneration and small power production, utilities can reduce the burning of fuel and construction of plants than would otherwise be required." (R. 1217)[7]

Consolidated Edison Company of New York, Inc., petitioner in the court below, serves with electricity a territory The Brooklyn Union Gas Company serves with gas. Brooklyn Union advised the Commission in the rulemaking proceeding:

> "Among those parties most vociferously opposing the use of natural gas for 'inferior' cogeneration purposes are electric utilities which are actively engaged in dissipating this nation's 'gas bubble' by using gas as boiler fuel in the generation of electricity. In light of the efficiency standards which the Commission has proposed for gas-fired CFs [cogeneration facilities] which seek qualifying facility status, Brooklyn Union submits that the twin goals of conserving natural resources and maximizing fuel use efficiency could be better achieved by use of natural gas in CFs which meet the Commission's efficiency standards and the termination, at the earliest possible date, of programs which encourage or permit consumption of vast quantities of natural gas in comparatively inefficient utility central electric generating stations." (R. 1418)[8]

The electric utilities successfully persuaded the court below that the statutes which regulate their activities should be so interpreted that they would be preserved

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[7] Record reference is to the record in the court below.

[8] Record reference is to the record in the court below.

from the competition from cogeneration facilities which the Commission's rules would encourage. Apart from the fact that the lower court's construction of PURPA is erroneous, for reasons set out in the petition for writ of certiorari, it needlessly suppresses opportunities for competition in the bulk electric power industry where competition can and ought to exist.[9]

4. "Section 210 of PURPA's Title II . . . seeks to encourage the development of cogeneration and small power production facilities." *Federal Energy Regulatory Commission* v. *Mississippi*, ___ U.S. ___ (1982), 50 U.S.L.W. 4566, 4568 (June 1, 1982). Faced with the obligation to adopt rules encouraging the development of cogeneration, the Commission chose means which would accomplish that result. The lower court did not conclude otherwise.

One may well argue that there are better ways to accomplish that legislative end, ones that are more "fine-tuned" in terms of either economics or the concerns of the electric utilities. But "[a]lthough this inquiry into the facts is to be searching and careful, the ultimate standard of review is a narrow one. The court is not empowered to substitute its judgment for that of the agency." *Citizens to Preserve Overton Park* v. *Volpe*, 401 U.S. 402, 416 (1971).

The Commission's rules were within the granted power, issued pursuant to the proper procedure, and have a reasoned basis. See *Bowman Transportation, Inc.* v. *Arkansas-Best Freight System, Inc.*, 419 U.S. 281, 285

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[9] See *Otter Tail Power Co.* v. *United States*, 410 U.S. 366 (1973); *Gainesville Utilities Department* v. *Florida Power and Light Co.*, 573 F.2d 292 (5th Cir. 1978), *cert. denied*, 439 U.S. 966 (1978).

(1974). The contrary decision of the lower court needs to be overturned as requested by Petitioner.

CONCLUSION

The Petition for Writ of Certiorari should be granted.

Respectfully submitted,

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IN THE

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AMERICAN PAPER INSTITUTE, INC.,

Petitioner,

—v.—

AMERICAN ELECTRIC POWER SERVICE CORP., *et al.*,

Respondents.

FEDERAL ENERGY REGULATORY COMMISSION,

Petitioner,

—v.—

AMERICAN ELECTRIC POWER SERVICE CORP., *et al.*,

Respondents.

ON WRITS OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

BRIEF FOR PETITIONER AMERICAN PAPER INSTITUTE, INC.

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QUESTIONS PRESENTED

1. Whether the Court of Appeals misapprehended or grossly misapplied the appropriate standard of judicial review in setting aside a rule promulgated by the Federal Energy Regulatory Commission under § 210 of PURPA setting a rate formula for utility purchases of electricity from new qualifying alternative energy sources?

2. Whether, in holding that §§ 210 and 212 of the Federal Power Act provide the exclusive means by which the Federal Energy Regulatory Commission may require utilities to interconnect with qualifying alternative energy sources, the Court of Appeals improperly frustrated the clearly expressed Congressional intent of § 210 of PURPA by rejecting the Commission's contemporaneous construction and harmonization of these statutes?

PARTIES TO THE PROCEEDING BELOW

Parties before the Court of Appeals in addition to petitioner* and respondents named in the caption of this case were intervenors Occidental Geothermal, Inc., Elizabethtown Gas Company and Brooklyn Union Gas Company.

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* A listing of parent companies, subsidiaries and affiliates of petitioner, as required by Rule 28.1 of the Revised Rules of the Supreme Court, appears in the Appendix to this brief, beginning at page A-1.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1982

Nos. 82-34 and 82-226

AMERICAN PAPER INSTITUTE, INC.,
Petitioner

—v.—

AMERICAN ELECTRIC POWER SERVICE CORP., *et al.*,
Respondents

FEDERAL ENERGY REGULATORY COMMISSION,
Petitioner

—v.—

AMERICAN ELECTRIC POWER SERVICE CORP., *et al.*,
Respondents

ON WRITS OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

BRIEF FOR PETITIONER AMERICAN PAPER INSTITUTE, INC.

OPINIONS BELOW

The opinion of the Court of Appeals for the District of Columbia Circuit is officially reported at 675 F.2d 1226, and is reproduced in Appendix B to the petition of American Paper

Institute, Inc. ("API") for a writ of *certiorari*, at B-1.[1] The order denying rehearing is officially reported at 675 F.2d 1226, 1246, and appears at B-202. The order denying rehearing *en banc*, and the dissenting statement of Circuit Judges Wald and Mikva are officially reported at 675 F.2d 1226, 1247, and begin at B-205.

Federal Energy Regulatory Commission ("FERC" or "the Commission") Order No. 69, dated February 19, 1980, was published in the Federal Register at 45 Fed. Reg. 12,214 (1980), and appears at B-38. FERC Order No. 70, dated March 13, 1980, was published at 45 Fed. Reg. 17,959 (1980), and is reprinted at B-120. The Commission's Order of May 15, 1980, granting in part and denying in part rehearing of Order Nos. 69 and 70, and amending regulations, was published at 45 Fed. Reg. 33,958 (1980), and appears at B-175.

JURISDICTION

On January 22, 1982, the Court of Appeals entered its Judgment. B-200. A timely petition for rehearing and a suggestion for rehearing *en banc* were denied on April 9, 1982. B-202, 205. A petition for a writ of *certiorari* was filed on July 8, 1982, within ninety days of the date of denial of rehearing. The writ was granted on October 12, 1982, and consolidated with *Federal Energy Regulatory Commission* v. *American Electric Power Service Corp., et al.*, No. 82-226. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

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1 Pursuant to Rule 30.1 of the Revised Rules of the Supreme Court, the opinions below and the orders of the Federal Energy Regulatory Commission have been reproduced in Appendix B to API's petition for a writ of *certiorari* in this case and are not being reproduced again. Citations to that Appendix have the prefix 'B' in this brief. Citations to the record of rulemaking, which was before the Court of Appeals, contain the prefix 'R,' and citations to the Joint Appendix have the prefix 'JA.'

STATUTORY AND REGULATORY PROVISIONS INVOLVED

This case involves the following statutory and regulatory provisions set out verbatim in the Appendix to this brief, beginning at the page indicated.

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STATEMENT OF THE CASE

On November 9, 1978, the Public Utility Regulatory Policies Act of 1978, Pub. L. No. 95-617, 92 Stat. 3117 (1978) ("PURPA"), was signed into law. PURPA was part of a comprehensive package of legislation designed to combat the nationwide energy crisis.

A. Information Available to Congress During Consideration of PURPA

As this Court observed in *Federal Energy Regulatory Commission* v. *Mississippi*, ____ U.S. ____, 102 S. Ct. 2126, 2130, (June 1, 1982), when PURPA was being considered by the

Congress, it was said that the generation of electricity consumed more than 25% of all energy resources used in the United States. Approximately one-third of the electricity used in this country was generated through the use of oil and natural gas. These factors had an adverse effect on rates to consumers and on the economy as a whole. Congress accordingly determined that conservation of oil and natural gas by electric utilities was essential to the success of any effort to lessen the country's dependence on foreign oil. In addition to conservation, Congress also determined to promote more efficient use of scarce energy resources.

The evidence before Congress showed that a significant contribution to these ends could be made by alternative sources of energy. For example, "it was estimated that if proper incentives were provided, industrial cogeneration alone could account for 7% to 10% of the Nation's electrical generating capacity by 1987."[2] 102 S. Ct. at 2136.

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2 Cogeneration is the sequential use of energy to produce both electricity and a useful form of thermal energy (such as steam or heat) for industrial, commercial, heating, or cooling purposes. 18 C.F.R. § 292.202(c)(1982). Cogeneration in the paper industry normally consists of production of steam under high pressure which is first expanded through a turbine to generate electric power and then extracted from the turbine at lower pressures and used in the industrial process for such things as mechanical drives, pulping and drying, bleaching and space heating. R 2486-87.

While large public utility generating plants are more efficient in producing electricity than are industrial generating plants which only produce electricity, the sequential reuse of the energy in the cogenerating plant is more efficient overall. A public utility converts 38-39% of the fuel Btu input into electric power. In a typical paper plant, 72% of the total Btu input is used in the manufacturing process and another 10% of the input is converted into electric energy. Thus the paper mill achieves an 82% conversion of available Btu's into useful energy—electric power and process steam—as against only 38% for the utility. Put another way, the typical efficient oil-fired utility plant will produce one kilowatt-hour of electric energy for every 10,500 Btu's of fuel consumed. In a typical cogeneration facility at a pulp mill, the production of one kilowatt-hour consumes approximately 5,400 Btu's of fuel. *See generally* Robert T. Clark, *Theoretical Cogeneration Potential of the U.S. Pulp and Paper Industry* 3, Exhibit 1 (April, 1978). R 949, 956. The potential savings of oil and gas are com-

Section 210 of PURPA reflects Congress' effort to achieve these goals by encouraging the development of cogeneration and small power production facilities.[3]

Earlier this year, this Court upheld the constitutionality of PURPA against a facial challenge. *Federal Energy Regulatory Commission* v. *Mississippi, supra,* 102 S. Ct. 2126. As the Court there observed, Congress believed that two problems discouraged the development of nontraditional sources of electricity. One was the reluctance of traditional electric utilities to purchase the electric power produced by such facilities and to sell them needed backup or supplemental electric power. The other was the threat of state and federal regulation of any such facilities that desired to sell their electrical output. 102 S. Ct. at 2132-33.

B. FERC's Mandate in § 210 of PURPA

Section 210 of PURPA was a remedial statute designed to overcome both of these obstacles to development. In PURPA

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pounded when the paper mill uses its own waste products such as bark or spent chemicals from the pulping process as fuel. Today these waste products constitute approximately 50% of the fuel used at pulp and paper mills. R 2487, Vol. 1, 13SE.

3 A "cogeneration facility" is defined in § 201 of PURPA as one that produces both electric energy and steam or some other form of useful energy, such as heat, used for industrial, commercial, heating, or cooling purposes. 16 U.S.C. § 796(18)(A)(1976 ed., Supp. III). A "small power production facility" is one that produces electric energy solely by the use of biomass, waste or renewable resources (such as wind, water or solar energy) as a primary energy source, and has a power production capacity of not more than 80 megawatts. 16 U.S.C. § 796(17)(A).

By Pub. L. 96-294, 94 Stat. 770, which was signed into law on June 30, 1980, Congress added "geothermal resources" and "geothermal power producers" to various sections of PURPA. That legislation became effective after promulgation by FERC of the rules at issue and is, therefore, not directly relevant to this case. The statutes printed in the Appendix to this brief are, therefore, those in existence at the time the rules under PURPA § 210 were promulgated in February, 1980.

§ 210(a), Congress directed that within one year, FERC was to prescribe:

> "such rules as it determines necessary to encourage cogeneration and small power production which rules require electric utilities to offer to—
>
> (1) sell electric energy to qualifying cogeneration facilities and qualifying small power production facilities and
>
> (2) purchase electric energy from such facilities." 16 U.S.C. § 824a-3(a) (1976 ed., Supp. III).

To overcome developers' and investors' concerns over the threat of state and federal utility-type regulation, PURPA § 210(e) required FERC to:

> "prescribe rules under which qualifying cogeneration facilities and qualifying small power production facilities are exempted in whole or part from the Federal Power Act, from the Public Utility Holding Company Act, from State laws and regulations respecting the rates, or respecting the financial or organizational regulation, of electric utilities, or from any combination of the foregoing, if the Commission determines such exemption is necessary to encourage cogeneration and small power production." 16 U.S.C. § 824a-3(e).

The statute further directed FERC to promulgate its rules after consultation with state and federal regulatory agencies, and after public notice and a reasonable opportunity for interested persons to submit oral and written data, views and arguments. 16 U.S.C. §§ 824a-3(a),(e).

C. FERC's Rulemaking Proceedings

Pursuant to that Congressional direction, FERC instituted two major rulemaking proceedings. In one proceeding, FERC Docket No. RM79-54, the Commission considered and determined how and which cogeneration and small power produc-

tion facilities may become "qualifying" facilities. In the second proceeding, FERC Docket No. RM79-55, the Commission considered and promulgated rules which frame the relationship between qualifying facilities and electric utilities under PURPA § 210, and defined the scope of the exemptions from regulation that would be necessary to encourage development of such facilities.[4] A brief recitation of the principal activities involved in these proceedings will illustrate the thoroughness and dedication with which the Commission pursued its appointed task.

In June of 1979, FERC issued proposed rules in Docket No. RM79-54. R 348-388H. FERC also issued at that time a Staff Discussion Paper in Docket No. RM79-55, which addressed numerous issues relating to the relationship of qualifying facilities and utilities, and to the appropriate scope of exemption from utility-type regulation. JA 6. Public hearings were held in San Francisco, Chicago and Washington, D.C. with respect both to the proposed rules and to the Staff Discussion Paper. R Vol. 1, 1-119SF, 1-87Chi, 1-280DC1. Extensive written comments were also received.

On October 18, 1979, the Commission issued a Notice of Proposed Rulemaking under § 210 of PURPA in Docket No. RM79-55, made available its preliminary environmental assessment of the proposed rules and invited further public comment. JA 36. In order to obtain the data, views and arguments of interested parties, FERC again held public hearings in four cities across the Nation in November and December, 1979. R

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4 American Paper Institute, Inc., is the national trade association of the pulp, paper and paperboard industry in the United States. R 932. This industry is the Nation's leader in the self-generation and cogeneration of electric power, and accounts for over 40% of all cogeneration in the United States today. As an industry it is also the Nation's third largest *purchaser* of electricity from electric utilities. API actively participated in the rulemaking proceedings, submitting comments on four separate occasions. R 932, 1393, 2014, 2486. In addition, API representatives testified at hearings conducted by FERC. R Vol. 1, 12 SE (Hearings in Seattle, Washington, November 19, 1979).

Vol. 1, 1-169SE, 1-296NY, 1-180Col, 1-347DC2. Again, voluminous written comments were received.

After consideration of this information, the Commission made available final draft rules in January, 1980. R 3403-05. State public utility commissioners and electric utility representatives commented on this draft at separate public meetings held February 5 and 8, 1980. R Vol. 1, 1-165DC3, 1-186DC4. All comments were considered before the Commission issued Order No. 69, its final rules in Docket No. RM79-55 implementing § 210 of PURPA, on February 19, 1980. B-38. The Commission then issued Order No. 70, its final rules with respect to qualification of facilities in Docket No. RM79-54 on March 13, 1980. B-120.

On March 19 and 20, and April 3, 1980, the Commission received the petitions and applications for rehearing of the respondents in this case, American Electric Power Service Corp., Consolidated Edison Co. of New York, Inc., and Colorado-Ute Electric Association, Inc. R 3458, 3568, 3595. These petitions challenged the rules at issue here with essentially the same arguments as the utilities later presented to the Court of Appeals. In addition, at least one petition urged FERC to adopt a percentage-of-avoided costs rate for purchases. R 3553. On May 15, 1980, having duly considered these and other requests for rehearing of Order Nos. 69 and 70, FERC granted them in part and denied them in part and amended four sections of its rules involving small power production. B-175.

The procedures and deliberations described above were among the most comprehensive the Commission has ever undertaken. The final rules, produced after developing a record of over 4,000 pages of written comments and recorded testimony, address virtually every significant aspect of the relationship between qualifying facilities and utilities. B-105-19; B-167-74.

In July, 1980, three electric utilities, respondents in this Court, sought review of four rules in the Court of Appeals for

the District of Columbia Circuit. Two of those rules were upheld by the Court of Appeals and are not the subject of this brief. The other two rules, which go to the very heart of § 210 of PURPA, were set aside. The first of those was the so-called "avoided costs" portion of the purchase rate rule. 18 C.F.R. § 292.304(b)(2)-(4). This rule established the criteria for determining the rate which utilities would be required to pay for purchases of electricity from qualifying facilities constructed after the effective date of PURPA, absent agreement between the parties. The other rule vacated by the Court of Appeals simply required electric utilities to interconnect with qualifying facilities in order to enable purchase and sale transactions to take place. 18 C.F.R. § 292.303(c)(1).[5]

SUMMARY OF ARGUMENT

In rejecting FERC's purchase rate rule, the Court of Appeals' panel applied the wrong standard of review. The correct standard of review is the "arbitrary and capricious" test. Even under the heightened standard of review (the "substantial evidence" test) which the panel apparently applied, it grossly misapprehended or misapplied the test by arrogating to itself the interest-balancing functions entrusted by Congress to the Commission, and by requiring FERC to develop a rule in accordance with the court's own preferences. In so doing, it disregarded numerous decisions of this Court that a reviewing court should not substitute its judgment for that of the agency charged by Congress with the proper administration of the statute.

It also refused to follow this Court's admonishment to give due regard to the administrative expertise of the agency. The panel below failed to recognize that FERC's purchase rate rule

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5 The proceedings in the court below are described in detail in the brief for the Commission in No. 82-226, and will not be repeated here. The full text of the Commission's rules is found at B-105-19.

did not establish a fixed dollar amount to be paid by utilities. .. assumed incorrectly that the rule would always result in utilities paying the full avoided costs for energy produced by new qualifying facilities.

FERC drafted its rules to encourage utilities and developers of potential alternative energy sources to negotiate their relationship. At the same time, FERC, recognizing the leverage that utilities have in such negotiations, accommodated the Congressional policy to encourage alternative energy sources by improving the bargaining posture of those wishing to construct new qualifying facilities. The panel, however, insisted that such encouragement must be tempered by making available to utilities' customers whatever short-term benefits could be extracted regardless of how insignificant they may be, and refused to consider the long-term benefits to the customers and public at large. These long-term benefits include reducing the Nation's dependence on foreign sources of oil and the more efficient use of energy resources, as well as ancillary benefits to consumers including reduced utility capital requirements, improved reliability of supply through more decentralized generation and environmental benefits. All of these factors were developed on the record and considered by FERC in selecting the rate formula.

With respect to the interconnection rule, the Court of Appeals, contrary to well-established rules of law, rejected the Commission's rational harmonizing of its own enabling statutes. The panel applied an unreasonably restrictive view of Congressional intent in enacting PURPA, and thereby denied FERC the power Congress obviously sought to give. By requiring FERC to conduct case-by-case hearings under the Federal Power Act as a predicate to interconnection for purchase or sale transactions, the panel overrode PURPA's express determination that the implementation function be performed by the state regulatory authorities. Its view imputes to Congress the contradictory intention of encouraging cogeneration and small power production in one paragraph of the statute, while stifling development of those sources in a different

paragraph of the same statute. In so construing the statute, it failed to heed this Court's direction that statutes are to be construed as a whole in order to harmonize all parts and give effect to each. Instead, it assumed a degree of prescience in the draftsmen which this Court has stated cannot be given.

The decision below ignores FERC's Congressional mandate to prescribe such rules as it determines necessary to encourage cogeneration and small power production and creates a formidable, and perhaps insurmountable, roadblock to a major energy program.

ARGUMENT

I.

IN SETTING ASIDE THE COMMISSION'S PURCHASE RATE RULE, THE COURT BELOW APPLIED THE WRONG STANDARD OF REVIEW, IMPROPERLY SUBSTITUTED ITS JUDGMENT FOR THAT OF THE COMMISSION, AND MISUNDERSTOOD THE PURPOSE AND EFFECT OF THE RULE

A. The Court Below Should Have Applied the "Arbitrary and Capricious" Standard of Review and Upheld the Commission's Rule

This Court has repeatedly stated that regulations promulgated after informal rulemaking are subject to an "arbitrary and capricious" standard rather than the "substantial evidence" test that the panel presumably applied.[6] *See, e.g., FCC*

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6 As stated by the dissenters from the Court of Appeals' denial of rehearing below, "[t]he panel's opinion appears to assume that the substantial evidence test governs review of rules promulgated under the Public Utility and [sic] Regulatory Policies Act of 1978, Pub. L. No. 95-617, 92 Stat. 3117 ('PURPA'). *See* slip op. at 13 (*citing* Public Sys. v. FERC, 606 F.2d 973 (D.C. Cir. 1979))," B-207, n.2.

The court's application of the substantial evidence test may have been the result of an erroneous assumption—that the Court of Appeals had jurisdiction to review PURPA § 210 rules directly under § 313(b)

v. *WNCN Listeners Guild,* 450 U.S. 582, 594 (1981); *FCC* v. *National Citizens Committee for Broadcasting,* 436 U.S. 775, 802-03 (1978). Judges Wald and Mikva, dissenting from the denial of rehearing below, stated correctly that:

> "PURPA . . . does not set forth a heightened standard of review. The avoided cost rule is therefore subject to the general requirements of the APA, and may be overturned if it is 'arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law.' 5 U.S.C. § 706 (2)(A)." B-207, n.2.

Under that standard, "[t]he court is not empowered to substitute its judgment for that of the agency." *Citizens to Preserve Overton Park* v. *Volpe,* 401 U.S. 402, 416 (1971).

When Congress directs an administrative agency to promulgate rules, the reviewing court has a limited function. As this Court stated in *United States* v. *Shimer,* 367 U.S. 374, 383 (1961), if the choice made by the agency:

> "represents a reasonable accommodation of conflicting policies that were committed to the agency's care by the statute, we should not disturb it unless it appears from the statute or its legislative history that the accommodation is not one that Congress would have sanctioned."

Here, of course, Congress sanctioned a purchase rate which would encourage cogeneration and small power production. Its

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of the Federal Power Act ("FPA"), which prescribes the substantial evidence test for review of Commission actions under the FPA. 16 U.S.C. § 825*l*(b). API raised this jurisdictional issue on petition for rehearing below. The panel apparently believed it had pendent jurisdiction because one of the issues below (the so-called "fuel-use" issue) arose in the court's review of rules issued under § 201 of PURPA, which, unlike § 210, is an amendment to the FPA. 16 U.S.C. § 796. Even with pendent jurisdiction properly asserted over review of the PURPA § 210 rules, however, the appropriate standard of review is *not* a matter over which the court may similarly exercise its discretion. The Administrative Procedure Act, not the FPA standard, applied to the court's review of the rules at issue here.

primary limitation was that the rate not exceed the avoided costs of the purchasing utility; and it is not contended that the purchase rate rule promulgated by the Commission does so.[7]

The agency is only required to set out the reasons for its rulemaking in a "concise general statement of [the rules'] basis and purpose." Administrative Procedure Act § 4(c), 5 U.S.C. § 553(c)(1976). The Administrative Procedure Act does not require detailed and comprehensive findings of fact. *Camp* v. *Pitts*, 411 U.S. 138, 143 (1973). A "curt" explanation which indicates "the determinative reason for the final action taken" satisfies the statutory requirement. *Id.* at 143.[8] As described *infra* at 16-17, the Commission's explanation of its determination to adopt the avoided costs standard far exceeded these minima.

This Court has recognized that agency decisions "must sometimes rest on judgment and prediction rather than pure factual determinations." *FCC* v. *WNCN Listeners Guild, supra*, 450 U.S. at 594. "In such cases," the Court observed, "complete factual support for the Commission's ultimate conclusions is not required since ' "a forecast of the direction in which future public interest lies necessarily involves deductions based on the expert knowledge of the agency." ' " *Id.* at 594-95 (citations omitted).

The decision below failed to give due consideration to the obvious fact that at the time of the rulemaking extensive experience with alternative energy sources was lacking, and it was difficult to predict with any degree of assurance the

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7 The Court of Appeals acknowledged that FERC's avoided costs standard "is identical to the statutory concept of the 'incremental cost . . . of alternative energy.' " B-8, n.28.

8 *See also Bowman Transportation Inc.* v. *Arkansas-Best Freight System, Inc.*, 419 U.S. 281, 290 (1974) ("we can discern in the Commission's opinion a rational basis for its treatment of the evidence, and the 'arbitrary and capricious' test does not require more").

specific consequences of any particular rate for purchases.[9] FERC was required, nonetheless, to apply its expertise in developing rules which would accomplish the Congressional directive to encourage cogeneration and small power production. Accordingly, FERC adopted a purchase rate rule which, in the Commission's judgment, "may provide a significant incentive for a higher growth rate of these technologies." B-65.

FERC weighed the competing interests and determined that although a rate based on avoided costs would not produce any significant rate savings to the utilities' customers, in the long run they and the Nation as a whole would benefit from the resulting decreased reliance on scarce fossil fuels and more efficient use of energy. *See* B-65.[10] That determination was not arbitrary or capricious, and the panel below was not authorized to reject it.

B. Even Under a Substantial Evidence Test the Court of Appeals Misapplied that Standard by Supplanting the Commission's Balance of the Pertinent Interests with Its Own

The failure of the panel below to uphold FERC's avoided costs rule may be traced to several causes, not the least of which is that it simply disagreed with the determination made by the Commission that the avoided costs standard was just and reasonable to ratepayers and at the same time was the most viable means of attaining Congress' goal of encouraging development of alternative energy sources.

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9 Many commenters recognized that the rules should be periodically reviewed, and revised if necessary. R 1249, 2477, 2786. Congress recognized that this was desirable, especially given the abbreviated time frame it had allowed for the Commission's work. It specifically directed in § 210(a) that "the Commission shall prescribe, and from time to time thereafter revise, such rules . . . ." 16 U.S.C. § 824a-3(a). FERC and the participants in the rulemaking proceedings recognized these conditions. The Court of Appeals panel failed to do so.

10 With respect to the various interests and benefits considered by FERC, see pp. 18-25. *infra*.

Although, as noted earlier, the Commission's rule was within the permissible range established by Congress, the court set the rule aside because it was at the upper bound of that range. The panel's preconceived notion of an appropriate rate was presaged when it rejected FERC's initial challenge to the utilities' standing:

> "If petitioners prevail before this court, the rule will be changed to permit the states to allow the petitioners to purchase electricity at prices lower than those now required." B-7, n.26.

A fair reading of the opinion indicates that the panel simply imposed its perspective of the public interest on FERC. The panel makes it clear that in its view the only purchase rate which it would call just and reasonable to consumers would be one requiring utilities to pay something less than avoided costs. Thus, the panel directed that:

> "FERC should allocate the benefits more evenly between the cogenerators and the utilities if the utilities can demonstrate that, under a percentage of avoided cost approach, an allocation less heavily favoring the cogenerators is in the public interest and the interest of the utilities' electric consumers, and will not disproportionately discourage cogeneration." B-12.

In so stating, the panel manifested its determination that only a rule which in the short term saved utility customers a few cents per month on their electric bills could satisfy the statutory mandate that FERC's purchase rate be "just and reasonable" to those customers, and that such short-term consumer gain outweighs their own as well as the Nation's long-term interest in developing alternative energy sources. However, the determination of what weight should be accorded the short- versus the long-term interests of consumers and other interests required to be considered were, according to PURPA § 210, to be made by FERC, not by the Court of Appeals.

Having decided that the rate contained in the rules was too high, the panel made it clear that on remand the Commission should promulgate the purchase rate rule which the panel itself preferred. Thus, it stated that on remand:

> "[W]e expect the Commission to take a harder look at, especially, the percentage of avoided cost approach. Such an approach might, for example, entail FERC setting a specific percentage, or FERC might permit state commissions to set rates within a range—*e.g.*, 80-100 percent—authorized by the Commission." B-12.

But FERC had considered and rejected a percentage of avoided costs approach, and had fully explained its reasons for so doing. It gave several reasons for adopting the avoided costs standard:

> "[I]f part of the savings from cogeneration and small power production were allocated among the utilities' ratepayers, any rate reductions will be insignificant for any individual customer. On the other hand, if these savings are allocated to the relatively small class of qualifying cogenerators and small power producers, they may provide a significant incentive for a higher growth rate of these technologies." B-65.

Moreover, FERC said:

> "Although use of the full avoided cost standard will not produce any rate savings to the utility's customers, several commenters stated that these ratepayers and the nation as a whole will benefit from the decreased reliance on scarce fossil fuels, such as oil and gas, and the more efficient use of energy." *Id.*

Finally, FERC took particular note of comments that:

> "[U]nder the full avoided cost standard, the utilities' customers are kept whole, and pay the same rates as they

would have paid had the utility not purchased energy and capacity from the qualifying facility." *Id.*

The Court of Appeals refused to give credence to FERC's rationale for the rule. The panel stated that "it is possible that if cogeneration becomes substantial, a rate uniformly set at the statutory ceiling may be quite costly to electric consumers." B-11. The panel never explained the basis for this conclusion. It reflects, however, a fatal misunderstanding about the nature of avoided costs which infects the panel's entire opinion on this subject. By definition, the utility can incur no greater cost in purchasing power from a qualifying facility than it would experience if the utility generated the power itself or obtained it elsewhere. *See* 18 C.F.R. § 292.101(b)(6). As a result, the consumer will not pay more on account of sales by a qualifying facility.

Furthermore, the panel grossly misapplied the Congressional policy to encourage cogeneration by directing FERC to issue a rule which "will not *disproportionately discourage* cogeneration." B-12 (emphasis added). That was not the Congressional mandate. Rather, Congress expressly ordered FERC to do what it could to *encourage* cogeneration. *See Federal Energy Regulatory Commission* v. *Mississippi, supra*, 102 S. Ct. at 2132-33. FERC recognized that utility ratepayers were not to be required to subsidize cogenerators or small power producers. *See* JA 48; B-49; R 352. It also recognized, however, as did Congress, that encouragement would come only from economic viability. FERC chose a purchase rate for new facilities, therefore, which was within the limits prescribed by Congress, albeit at the upper end of the permissible range, in the exercise of its informed judgment that such a rate was necessary to encourage those projects. B-67-68.

In its insistence upon a "split the baby" approach to rate-making policy as between utilities and qualifying facilities, the

Court of Appeals disregarded the record, ignored FERC's reasoned consideration of the record and suggested that the utilities be given yet another opportunity to convince FERC to adopt a lower rate.

As this Court has recognized, however, judicial activism of this sort is improper. *See Vermont Yankee Nuclear Power Corp.* v. *NRDC*, 435 U.S. 519 (1978). Under the "substantial evidence" test, "[t]he court's responsibility is not to supplant the Commission's balance of these interests with one more nearly to its liking, but instead to assure itself that the Commission has given reasoned consideration to each of the pertinent factors." *Permian Basin Area Rate Cases*, 390 U.S. 747, 792 (1968); *see also Mobil Oil Corp.* v. *FPC*, 417 U.S. 283, 308 (1974).

C. In Arriving at its Avoided Costs Rule FERC Considered Each of the Interests Required by the Statute

(1) The Public Interest

The Court of Appeals simply ignored or refused to consider FERC's analysis, based upon the record, of the benefits available to the Nation from PURPA-induced cogeneration.

In its comments in Docket No. RM79-54, API submitted a study which estimated that in 1977, the fuel efficiency of industrial cogeneration resulted in a savings equivalent to 49 million barrels of oil, compared to the fuel that would have been consumed by utilities to produce the same amount of electricity. *See* Robert T. Clark, *Theoretical Cogeneration Potential of the U.S. Pulp and Paper Industry* 1 (April, 1978). R 947.

FERC itself projected during the course of this rulemaking that the successful implementation of PURPA would induce the additional development of 3,410 megawatts ("MW") of new industrial cogeneration capacity by 1995. R 2277, 2292. This capacity translates into additional fuel savings equivalent

to more than 21 million barrels of oil annually.[11] Since the commercial sector is expected to add another 2,500 MW of cogeneration capacity due to PURPA, R 2291, the total PURPA-induced savings available from cogeneration and small power production was estimated to approach the equivalent of 37 million barrels of oil annually.

The immediate economic effects of these savings are readily identifiable. Consumers will tend to experience lower prices for fuel than would otherwise exist with higher levels of demand.[12] In addition, the more efficient use of fuel through PURPA-induced cogeneration will result in net cost reductions for manufactured goods.

Such substantial savings are bound to have a positive impact upon the Nation's ability to control its own future with respect to energy resources. To the extent the savings will permit reducing imports of foreign oil and gas, American consumers will obtain relief from the artificially high prices of these fuels, as well as from the political and social costs that accompany overdependence on them.

The record further shows that PURPA-induced cogeneration and small power production will result in deferral or cancellation of construction of massive utility generating facilities, and will correspondingly diminish the potential environmental damage that accompanies such construction. Facilities, originally slated for construction between 1980 and 1995 which will be deferred as a result of this program have been projected by the Commission to include:

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11 This fuel savings assumes that 3,410 MW of industrial cogeneration capacity produces 25.391×10^9 kWh of electricity annually (at 85% utilization) at a fuel savings of 20-30% over utilities' central generation capacity. *See* R 2274.

12 The Commission estimated that approximately two-fifths of the fuel savings produced by PURPA will impact on the consumption of oil and natural gas; the remaining savings will affect the consumption of coal. *See* R 2258.

> "some eleven 500 MW coal-fired steam plants, one-1000 MW nuclear plant, a number of 75 MW gas turbines, and certain large scale hydropower and combined cycle installations." R 2258.

As stated in the Commission's assessment:

> "All of the environmental impacts associated with the construction and operation of these facilities would be avoided." *Id.*

(2) The Interests of Cogenerators and Small Power Producers

As the legislative history of PURPA § 210 made abundantly clear, one of the greatest obstacles to developing a cost effective alternative energy source was the reluctance of utilities to pay adequate rates for power purchased from those sources. *See Federal Energy Regulatory Commission* v. *Mississippi, supra,* 102 S. Ct. at 2132, n.12. Even where utilities were willing to purchase power, investors in such facilities could not rely on sufficient income to meet their costs, and to justify the risk and major capital expense required. The result is that a vast untapped resource lies dormant.[13] The paper industry, for example, is currently operating at only about one-third of its potential generating capacity. R 957-58.

FERC recognized that there is no particular price at which power generation becomes economic for all operators. Local energy costs, plant design and internal requirements are but a few of the many variables which make the investment decision unique to each potential developer.[14] Yet as FERC also recog-

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13 FERC's selection of a purchase rate at the avoided costs limit applies only to newly constructed facilities, *i.e.*, those whose construction commenced on or after November 9, 1978, the date when PURPA became law. 18 C.F.R. § 292.304(b). This rulemaking decision was obviously directed at this untapped resource.

14 Qualifying facilities are diverse and varied. They range from windmills, photovoltaic arrays and hydroelectric dams to industrial co-

nized, if the facility can produce electricity at a cost to the utility *no greater* than the utility would otherwise incur in purchasing or producing that electricity, the public, the utility and the utility's ratepayers will benefit. *See* B-65.

Throughout the rulemaking proceedings, one point was abundantly clear. If a prospective developer of an alternative energy source is to be encouraged to undertake the risk of developing a project, he must have a price sufficient to cover his costs (including costs of financing), and to compensate him for the risks he is undertaking. R 1291, 2423, Vol. 1, 213DC1, 57-58DC4. FERC recognized this. B-49. The generation of electricity is not the primary business of private industrial developers, and it will not be pursued unless potential returns are high enough to compete successfully in the company's capital budgeting process. Moreover, it was pointed out by commenters that many such projects require outside financing, but potential investors and lenders will not commit the neces-

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generation facilities. They range in size from less than 10 kilowatts, R 776, to larger than 200,000 kilowatts. *Public Utilities Regulatory Policies Act Amendments: Hearings on S. 1885 and S. 1966 Before the Subcomm. on Energy Regulation of the Senate Comm. on Energy and Natural Resources*, Part 1, 97th Cong., 2d Sess. 268 (1982) (supplemental statement of C.M. Butler III, Chairman, Federal Energy Regulatory Commission). They vary in cost from less than $10,000, R 3270, to more than $100,000,000. Wall Street Journal, February 25, 1982, p. 12, col. 4. They are owned by large industrial corporations and by individuals of very modest means. Their capital and energy costs may range from 3 cents per kilowatt-hour to more than 12 cents. *See* R 432.

Utilities also exhibit great diversity. Some are capacity short, others have excess capacity. *E.g., compare* R Vol. 1, 63NY *with* Wall Street Journal, November 17, 1982, p. 24, col. 1. Some generate almost exclusively with high cost fuels such as oil or gas, others generate at low cost with coal or water power. *See* U.S. Dept. of Energy, Inventory of Power Plants in the United States: 1980 Annual (DOE/EIA-0095 (80)). Avoided costs may range from less than 2 cents per kilowatt-hour to more than 8 cents. *Compare*, Iowa State Commerce Commission Order TF-81-202, Docket No. RMU-80-15-152 (1982) *with* New Hampshire Public Utilities Commission Order No. 14,280, Docket DE 79-208 (1980).

sary funds unless the project appears to be economically sound.[15] R 1311, 2882, Vol. 1, 86SF. A principal test of that economic viability is whether the anticipated receipts from the sale of power generated are sufficient to defray expected capital costs and expenses and yet permit a reasonable return for investors. R 883-84, 1291, 3374. Moreover, the more innovative the technology used in the project, the greater the risks to the developer. R Vol. 1, 134Col. If those innovative projects are to be undertaken, of course, some reward must be provided for the risk takers. R 1309-11, Vol. 1, 181-82DC1, 185DC1. FERC's rules took these facts into consideration; the Court of Appeals panel ignored or denigrated them.

(3) The Interests of the Consumers of Electricity

The additional power which will be supplied to utilities as the result of § 210 of PURPA will benefit consumers of electricity because it will improve the financial and operational viability of utilities. Utilities may expect four major benefits from PURPA-induced cogeneration and small power production, all of which they will receive cost-free, since they will incur expenses no greater than would have been experienced in the absence of PURPA-induced cogeneration and small power production. R 907.

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15 For example, Potsdam Paper Corp. pointed out that payment of avoided costs "would materially improve the ability of our company to obtain financing for our project in that the viability would not be solely dependent on the ability of the paper mill to take the electric output of the project. The intended incentive would place in front of the perspective [sic] lender a sales arrangement to a utility which would demonstrate ability to repay apart from our paper making operations." R 2882.

A broad spectrum of other potential developers expressed similar sentiments. *See, e.g.*, Comments of the Hawaiian Sugar Planters Association, R 1334, "the avoided costs' pricing standard . . . will constitute a necessary incentive for the production of additional biomass power by Hawaiian sugar factories;" testimony of the American Wind Energy Association, R Vol. 1, 134Col, "payment of full avoided costs could be necessary to bring any significant amount of generation stock on line soon."

i. Utilities will broaden and diversify their sources of electric power. This will insulate them to some extent from increases in the price of scarce fossil fuels, as well as from unexpected fluctuations in the availability of these fuels. *See* R 1522, 2459, Vol. 1, 153NY. Utilities' customers will receive the benefit of increased reliability of service resulting from their utility's diversified generation mix. R Vol. 1, 153NY.

ii. Utilities will obtain increased electrical generating capacity without expenditures for new plant and equipment. *See* R 3367, Vol. 1, 16 DC2, 142DC1.

iii. Since utilities will require no new financing to obtain this additional capacity, they will avoid any negative repercussions that might otherwise be experienced in going to the money market. In particular, they will avoid the business risk attendant to long-term financing at the high interest rates which exist today and are likely to persist. *See* R 1523-24, 3372, Vol. 1, 32-33NY.

iv. Utilities will be able to match more closely the growth of their capacity with growth in demand, and, consequently, to realize associated cost savings. This is because qualifying facilities will usually provide capacity in smaller increments than it would be cost-effective for utilities to build, and because new capacity from such facilities may be brought on line in shorter lead times than typically accompany the construction of large-scale central generating stations. *See* R Vol. 1, 151-52NY.

The record clearly demonstrated that the avoided costs rate is just and reasonable to the electric consumer.[16] The FERC rules preclude any increase in rates as a result of power purchases from qualifying facilities. R 907. In fact, the rules often may result in decreased rates to consumers.

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16 The National Association of Regulatory Utility Commissioners gave its full support to FERC's avoided costs rule. R 2833. Not a single one of the state utility regulatory commissions—which must be recognized

Under the Commission's rules, a utility is only required to pay for power when it is delivered and, therefore, ratepayers are not paying capital costs for new facilities before they come on line. Indeed, they will never have to pay for something they may never get.[17] Commenters during the rulemaking pointed out, on the other hand, that absent alternative energy sources, utilities would be obligated to obtain equivalent power by, in many cases, constructing new generating facilities. R 907, Vol. 1, 151-52NY. The costs of those new facilities are incurred long before they produce a single kilowatt of power and are often paid for by the utilities' current ratepayers even though benefits may not be received from the facilities for many years, if ever.

The Commission's rules similarly treat the ratepayer fairly in situations where the utility's existing facilities are more than adequate to meet its total system load. Thus, the rules require purchases of all electric energy and capacity available from a qualifying facility, but provide that the "purchase rate should only include payment for energy or capacity which the utility can use to meet its total system load." 18 C.F.R. § 292.303; B-53.[18]

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as the guardians of the ratepayers' interests—has sought a waiver of the rule. The paper industry represented by API purchases vastly more electricity than it sells, and therefore—unlike the utilities—has a vital interest as a ratepayer.

17 This is in stark contrast to the consumer's plight in many areas of the Nation today. The Washington Public Power Supply System, for example, currently owes $2.25 billion in principal and $4.75 billion in interest for two incomplete nuclear-power plants which were abandoned because of cost overruns. New York Times, January 23, 1982, p. 31, col. 3. These cancellations may result in rate increases for consumers of up to 80%. Wall Street Journal, January 28, 1982, p. 16, col. 2.

18 For example, the purchase rate should only include payment for capacity when the availability of capacity from the qualifying facility will enable the utility to reduce its capacity requirements by deferring the construction of new plants or deferring commitments to firm power purchase contracts. 18 C.F.R. § 292.304(e); B-77.

Finally, the Commission's rules provide a "safety valve" procedure by which a state regulatory authority may apply to FERC for a lower rate whenever it believes an avoided costs rate is not necessary to encourage cogeneration and small power production.[19] 18 C.F.R. § 292.403. If, as the panel believed, a purchase rate based on avoided costs might in some cases excessively favor alternative energy sources, a waiver sought by the state agency charged with protecting the interests of all utility customers is the appropriate remedial course. Judicial nullification of the rule was not.

D. The Court of Appeals Misapprehended the Purpose and Effect of the Avoided Costs Rule

The Court of Appeals apparently believed that all purchases of electricity from qualifying facilities would be at the utilities' avoided costs. It considered the avoided costs part of the purchase rate rule in isolation and failed to put it into the context of the entire PURPA § 210 rules. Those rules endorse arrangements between utilities and qualifying facilities in which the parties negotiate a rate for purchases, or terms and conditions relating to purchases, which differ from the rate or terms otherwise required by the rules. 18 C.F.R. § 292.301(b)(1).

There are a number of reasons why a potential developer will attempt to engage in negotiations with a utility rather than going before a state public service commission for an avoided costs rate. State commission proceedings are time consuming

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19 This Court has repeatedly indicated that an agency's discretion to proceed in complex areas through general rules is closely connected to the existence of a "safety valve" procedure that allows the agency to consider applications for waivers based on special circumstances. *See E.I. duPont DeNemours & Co.* v. *Train*, 430 U.S. 112, 128 (1977); *Permian Basin Area Rate Cases, supra*, 390 U.S. at 771-73; *National Broadcasting Co.* v. *United States*, 319 U.S. 190, 207, 225 (1943). As noted earlier, not a single state public utility regulatory commission to date has considered it necessary to apply for a waiver of the avoided costs portion of the purchase rate rule.

and expensive. A utility may also seek judicial review of a state commission order and thereby cause further delay and expense. A decision by a developer to construct a project and a decision by a bank to finance a project require a degree of certainty regarding the economic viability of the project. A negotiated contract can provide certainty. It can insulate the developer from future changes in a state public utility commission's rules or rates and declines in avoided costs during the project construction period.[20]

Once the developer decides to bargain, he is faced with the substantial leverage of the utility. A qualifying facility generally has only one available utility to which its electric energy can be sold. Numerous commenters in the Commission's rulemaking referred to the monopsony power of the utilities and the effect of such market power on the negotiating position of prospective developers.[21] R 1186-87, 1523, Vol. 1, 186DC1, 219DC1. The owners of qualifying facilities testified that this monopsony power could force developers to enter into arragements with that utility on terms dictated by the utility. R 2443, 2843-44, Vol. 1, 38 Col.

The utility, which already possesses an intimate knowledge of its own costs, is in an inherently advantageous position in negotiating with the developer regarding the proper treatment of the factors to be considered in the calculation of avoided

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20 Any number of factors could result in lower avoided costs at a particular time, *e.g.*, a temporary drop in the price of oil, the bringing on line by the utility of a new plant which may have been under construction for several years, or the construction of several other qualifying facilities in the utility's service area.

21 The panel's criticism of FERC for failure to find that utilities possess monopsony power, B-16, suggests a limitation on FERC which is nowhere stated or implied in PURPA § 210. As this Court is aware, the Commission has had substantial experience in dealing with utility use and abuse of monopoly and monopsony power. *See Otter Tail Power Co.* v. *United States*, 410 U.S. 366 (1973); *see also* Meeks, J., *Concentration in the Electric Power Industry: The Impact of Antitrust Policy*, 72 Col. L. Rev. 64 (1972).

costs.[22] *See* R 1403, 3373. Moreover, utilities have little, if any, incentive to estimate their avoided costs accurately.[23] If, as is often the case, qualifying facilities are considered to be unwanted competition, there is considerable incentive for a utility to *under*state its costs.[24] The expense of disproving a utility's avoided costs figure is prohibitive for all but the very largest qualifying facilities. *See id.*

Another leverage point is delay. Utilities which stall negotiations can effectively kill many projects. Costs escalate and investment capital may be appropriated to other uses. In addition, much of the new cogeneration in the United States will be ancillary to expansions in plant capacity or to the reconstruction or replacement of obsolescent or inefficient boilers and related equipment. Delays may cause the owner of the reconstruction or replacement to forego the option to

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22 The flexibility of FERC's avoided cost formula itself encourages negotiation. It is not a mathematical formula. The factors required to be considered by the state regulatory authorities are neither quantified numerically nor weighted relative to each other. Such factors include the ability and willingness of the developer to enter into a firm commitment to deliver the power, which commitment may include significant penalty provisions for failure to deliver; another element of the calculation is the developer's ability to separate the facility's load from its generation during emergencies. 18 C.F.R. §§ 292.304(e)(2)(iii) and (v). Other such factors include the willingness or ability of the developer to permit the utility to dispatch—control the output of—the facility, 18 C.F.R. § 292.304(e)(2)(i), and the time of day or the season that the facility's energy is to be made available, 18 C.F.R. § 292.304(e)(2).

23 The rules require each regulated utility to submit data from which avoided costs may be derived to its state regulatory authority no later than November 1, 1980, May 31, 1982, and not less often than every two years thereafter with certain exceptions not here relevant. Non-regulated utilities are required to maintain similar data for public inspection. 18 C.F.R. § 292.302.

24 The strenuous efforts of utilities to discourage cogeneration, which in part led to the passage of § 210, are described in the legislative history cited in *Federal Energy Regulatory Commission* v. *Mississippi*, *supra*, 102 S. Ct. at 2132, n. 12.

cogenerate, as business conditions may not permit the passage of a year or two before expanding, replacing or reconstructing essential plant and equipment.[25]

Utilities consequently possess tremendous leverage in negotiations. The purchase rate rule took this into account—it gives developers the ultimate right to obtain an avoided costs rate from a state commission *if* they are unable to negotiate a satisfactory contract with the utility. Thus, as FERC expressly recognized, "the ability of a qualifying cogenerator or small power producer to negotiate with an electric utility is buttressed by the existence of the rights and protections of these rules." B-49.

The avoided costs rule is in practice a last resort for the developer, used only when a satisfactory rate simply cannot be negotiated *and* the potential owner of the qualifying facility has the time and money to press the issue before the state public utilities commission. Indeed, what FERC contemplated is precisely what has occurred. Most contracts since promulgation of the rules have been negotiated.[26]

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25 Delays are particularly harmful to those wishing to construct a hydroelectric qualifying facility. Under federal law, preliminary permits issued to preserve one's priority in the licensing process while feasibility studies are made are granted for a limited period of time. 16 U.S.C. § 798 (1976). In many instances, the permit has a life of only 18 months. *See, e.g., Energenics Systems, Inc.*, 19 F.E.R.C. No. 5905-000, 1982 FERC Dec. (CCH) ¶ 62,543 (1982); *Woods Creek, Inc.*, 19 F.E.R.C. No. 5816-000, 1982 FERC Dec. (CCH) ¶ 62,262 (1982). Therefore, a developer who holds out too long in negotiations with a utility stands to lose his all-important status in the licensing process.

26 The Vice-President of Southern California Edison Company, in a recent Senate hearing on the cogeneration and small power production provisions of PURPA, stated that his company has signed 60 contracts with cogenerators and small power producers since the beginning of 1981, "*nearly all* of which have been negotiated at a rate below full avoided cost." *Public Utility Regulatory Policies Act Amendments: Hearings on Amendment No. 1452 to S. 1885 Before the Subcomm. on Energy Regulation of the Senate Comm. on Energy and Natural Resources*, Part 2, 97th Cong., 2d Sess. 110, 114 (1982) (statement of Dr. Glenn J. Bjorklund; emphasis supplied).

The failure of the Court of Appeals panel to appreciate the practical considerations of the entire purchase rate rule, which FERC took into account and which were uniquely within FERC's expertise, undermined the panel's review of the avoided costs rule. As a result, it improperly set the rule aside.

II.

IN VOIDING THE COMMISSION'S INTERCONNECTION RULE, THE COURT FRUSTRATED CLEARLY EXPRESSED CONGRESSIONAL INTENT AND IMPROPERLY LIMITED THE COMMISSION'S AUTHORITY UNDER PURPA

A. The Commission's Interconnection Rule Is In Accord With the Statutes and Congressional Intent to Encourage Alternative Energy Sources

The legislative history of PURPA demonstrates Congress' awareness of a primary obstacle to development of alternative energy sources—the unwillingness of utilities to purchase the power generated by such facilities, or to sell them the backup power they required.[27] *Federal Energy Regulatory Commission* v. *Mississippi, supra,* 102 S. Ct. at 2132. PURPA § 210 was aimed specifically at dismantling this obstacle by requiring utilities to offer to purchase from and sell to qualifying facilities. Congress chose to accomplish its aims through rules prescribed by the Commission. 16 U.S.C. § 824a-3(a).

The Commission's interconnection rule provides that:

> "[A]ny electric utility shall make such interconnections with any qualifying facility as may be necessary to accom-

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27 Particularly in the context of industrial cogeneration, the economics can be overshadowed by the risk of a plant shutdown due to generator failure if the servicing utility refuses to provide back-up power. The rates charged by a utility for such back-up service, or for supplementary power (regularly used in addition to that which is cogenerated), also have a substantial impact on the decision whether to cogenerate, especially if those rates are discriminatory. *See generally* "Con Ed Battles Energy Officials on Cogeneration", New York Times, November 2, 1980, § 8, p. 1.

> plish purchases or sales under this subpart. The obligation to pay for any interconnection costs shall be determined in accordance with § 292.306." 18 C.F.R. § 292.303(c).

The latter section requires that each qualifying facility pay interconnection costs as assessed by the state regulatory authority or nonregulated utility.

The panel set aside this rule as inconsistent with § 210(e)(3)(B) of PURPA, 16 U.S.C. § 824a-3(e)(3)(B), and with the procedural and substantive requirements of §§ 210 and 212 of the Federal Power Act, 16 U.S.C. §§ 824i and k (1976 ed., Supp. III).[28] B-22.

FPA § 210 authorizes FERC, among other things, to issue an order upon application or upon its own motion requiring "the physical connection of any cogeneration facility, any small power production facility, or the transmission facilities of any electric utility, with the facilities of [the] applicant." 16 U.S.C. § 824i(a)(1)(A). An order under this authority may *only* be issued after the Commission issues notice to the affected parties, affords an opportunity for an evidentiary hearing and makes certain specified determinations. 16 U.S.C. § 824i(b) and (c). In addition, FPA § 212 lists certain further steps which must be taken before such an order may issue. 16 U.S.C. § 824k(a), (b) and (c).

Section 210(e) of PURPA requires FERC to exempt qualifying facilities from various federal and state laws which might impede their development. It also provides, however, that:

> "No qualifying small power production facility or qualifying cogeneration facility may be exempted under this subsection from—
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> * * *
>
> (B) the provisions of section 210, 211 or 212 of the Federal Power Act or the necessary authorities

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28 The latter provisions were added to the FPA by PURPA §§ 202 and 204, respectively.

> for enforcement of any such provision under the Federal Power Act. . . ." 16 U.S.C. § 824a-3(e)(3)(B).

In requiring interconnection, the Commission was cognizant of § 210(e)(3)(B) of PURPA. *See* B-60, 180-81. FERC's interconnection rule, however, does not exempt qualifying facilities from those sections.

The Commission pointed out that PURPA § 210(e) empowered it to exempt qualifying facilities from certain state and federal laws to the extent necessary to encourage the development of such facilities. B-180-81. FERC correctly understood that Congress' intent in granting this exemption authority was to remove the threat of utility-type regulatory burdens on qualifying facilities wherever possible, if necessary to encourage their development. Hence, stated the Commission:

> "[B]y exempting qualifying facilities from this type of regulation, Congress relieved them from liabilities and requirements to which others (*viz.*, non-qualifying facilities) are subject. Use of the word 'exempt' in this context is consistent with its definition: 'to release or deliver from some liability or requirement to which others are subject.' To 'exempt' qualifying facilities does not mean to deny them a privelege [sic] or right to which they would otherwise be entitled; to exempt means to relieve of undesirable responsibility or obligation." B-181 (footnote omitted).

In this light, FERC explained that qualifying facilities can either be applicants for or targets of interconnection orders under § 210 of the Federal Power Act. B-180. That section grants to electric utilities and federal power marketing agencies, as well as to qualifying facilities, the right to apply for an interconnection order. The "target" of such an interconnection order can, under the section, be "any cogeneration facility, any

small power production facility or the transmission facilities of any electric utility."[29] 16 U.S.C. § 824i(a)(1)(A); B-180.

Since, therefore, the Commission may make certain determinations under §§ 210 and 212 of the Federal Power Act which would result in the imposition of significant obligations on a qualifying facility, it is from those obligations that PURPA § 210(e)(3)(B) provides that such facilities may not be exempted. B-181. This reading, the Commission observed, "comports with the plain meaning of the statute and with the accepted use of the language." B-182. It precludes the Commission from relieving qualifying facilities from liability as targets of interconnection orders which are sought by others or, more importantly, which are issued by FERC on its own motion.[30]

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29 It is significant to note that a literal reading of FPA § 210 does not necessarily grant the right to a qualifying facility to obtain interconnection under that section for the purpose of purchases or sales. FPA § 210 (a)(1)(A) empowers the Commission to order:

> "(A) the physical connection of any cogeneration facility, any small power production facility, or the transmission facilities of any electric utility, with the facilities of such applicant."

16 U.S.C. § 824i(a)(1)(A).

Thus, a qualifying facility applying for interconnection with a utility under FPA § 210 would be faced with the argument that the connection can *only* be to the "transmission facilities" of the utility, not to its "distribution facilities."

30 Among other things, a qualifying facility can be ordered to interconnect with the transmission facilities of a utility or with another facility, qualified or not. Similarly, it can be required to take action with respect to its physical connection if the connection is of inadequate size, poorly maintained or physically unreliable. It can also be required to increase its transmission capacity. 16 U.S.C. § 824i(a)(1). These are obligations from which it cannot be exempted.

As FERC argues in its brief, Congress had intentionally created, in §§ 210-212 of the FPA, a much larger jurisdiction for FERC to exercise than it had ever possessed before, for the primary purpose of establishing a truly national transmission grid. The restriction in PURPA § 210(e)(3)(B) on FERC's exemption-granting authority was a necessary precaution to insure that FERC would not undo any part of that novel jurisdictional grant by relieving qualifying facilities of their potential obligations as targets of FERC interconnection orders.

Furthermore, the procedures and proofs involved in an FPA interconnection proceeding are redundant when a qualifying facility wishes to gain a utility interconnection. By requiring "any" utility to make interconnections with "any" cogenerator "FERC designates," the Court of Appeals stated, the Commission would "in effect" exempt qualifying facilities from the other procedural and substantive requirements in FPA §§ 210 and 212 "and deprive utilities of the safeguards afforded by those provisions." B-22. This rationale, however, depends upon a substantial overstatement of the problem faced by the utilities. Apart from the ability to demand a full evidentiary hearing and thereby to delay any interconnection, all the other "safeguards" afforded by FPA §§ 210 and 212 to utilities were adequately protected in FERC's rules.

Under FPA § 210(c), before ordering interconnection, FERC must determine that it is in the public interest and that the order would encourage overall conservation of energy or capital, or optimize the efficient use of facilities and resources, or improve the system reliability, and meet the requirements of FPA § 212. 16 U.S.C. § 824i(c).[31] Under FPA § 212 the Commission may not issue the order unless it determines that it is not likely to result in reasonably ascertainable uncompensated economic loss for the utility affected by the order, will not place an undue burden on that utility, will not unreasonably impair the reliability of the utility, will not impair the ability of the utility to render adequate service to its customers, and that the applicant can reimburse the utility for its expenses in making the interconnection.[32] 16 U.S.C. §§ 824k(a) and (b).

The Commission's rules (and the statute itself) place in the hands of the state regulatory authorities ultimate control over interconnection between utilities and qualifying facilities. This

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31 As these requirements indicate, interconnection orders pursuant to § 210 of the FPA will not automatically be granted.

32 FPA § 212(b)(2) also deals with orders under FPA § 211, which involves wheeling of power between utilities, and the Commission has construed it not to apply to qualifying facilities.

is manifestly consistent with the states' role as monitors of the overall safety and reliability of utility systems. In this respect, FERC broadly provided that the state regulatory authorities themselves establish "reasonable standards to ensure system safety and reliability of interconnected operations" based, *inter alia,* upon recommendations made by the utililties. 18 C.F.R. § 292.308.[33] Moreover, to assure that utilities would not incur unnecessary expenses by interconnection, the rules require the qualifying facility "to pay any interconnection costs which the State regulatory authority . . . or nonregulated electric utility may assess against the qualifying facility on a nondiscriminatory basis . . . . " 18 C.F.R. § 292.306(a).[34]

Under the panel's decision, however, these essentially local responsibilities are shifted back to FERC, which must make case-by-case determinations each time a utility exercises its right to request an evidentiary hearing on an application for interconnection by a qualifying facility.[35] If it is permitted to

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33 Utility concerns regarding the safety and reliability of interconnected operations have been alleviated as states have implemented the FERC rules. State utility commissions have made interconnection safety and reliability a primary element of their rules. In doing so, they have not hesitated to accommodate individual utilities' particular needs. In Colorado, for instance, over half of the Public Utility Commission's 42 pages of cogeneration and small power production rules are devoted to preserving utility system safety, reliability and recoverability of interconnection costs. Attachment 1 to Decision No. R81-801, Colorado P.U.C., May 6, 1981. In many other states, the utility commissions require a qualifying facility to comply with any reasonable utility demand related to interconnection safety and reliability. *See, e.g.,* Arkansas Public Service Commission Order No. 3 in Docket No. 81-071-F, April 29, 1982, § 3.8 (proposed rules); Public Service Commission of Indiana Rule No. 170 IAC 4-4-7(b) (March 20, 1981).

34 At the same time, state regulatory authorities were "to ensure that the interconnection requirements are reasonable, and that associated costs are legitimately incurred." B-91.

35 The panel's interpretation of the statutes also presents formidable practical problems with respect to the implementing role Congress

stand, that ruling will have needlessly erected, in the words of the dissenting judges below, "a formidable, perhaps insurmountable, roadblock to a major energy program." B-208.

FERC's construction of the statutes, however, which resulted in the interconnection rule, would prevent such an untoward result. As observed by the dissenters below, "[the Commission's] alternative interpretation is a plausible one and appears to be more closely in line with Congress' expressed desire to encourage cogeneration."[36] *Id.*

B. The Panel's Rejection of FERC's Interpretation Was Contrary to Principles Established by this Court

FERC's harmonious construction of these statutes was inherently reasonable. The panel's treatment of the Commission's interpretation is contrary to this Court's long-standing teaching that " 'the construction of a statute by those charged with its execution should be followed unless there are compelling indications that it is wrong.' " *N.Y. Dep't of Social*

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envisioned for state regulatory authorities in PURPA § 210(f). 16 U.S.C. § 824a-3(f). This section requires state authorities, not FERC, to enforce the rules prescribed by FERC under § 210(a). *Federal Energy Regulatory Commission* v. *Mississippi, supra,* 102 S. Ct. at 2137. A qualifying facility desiring to purchase and sell energy must, therefore, under the statutory mandate, pursue its rights before the state regulatory authorities. The Court of Appeals would, however, also require it to pursue its interconnection rights before FERC. This requirement would result not only in compounding the time and expense necessary to accomplish purchases and sales, but possibly in the issuance of mutually inconsistent orders.

36 As this Court stated in *Ozawa* v. *United States*, 260 U.S. 178, 194 (1922), the court will give a statute "effect in accordance with its design and purpose, sacrificing, if necessary, the literal meaning in order that the purpose may not fail." Again, the Court noted in *United States* v. *American Trucking Ass'ns*, 310 U.S. 534, 543 (1940), that when statutory language produces results divergent from Congressional purpose, "this Court has followed that purpose, rather than the literal words."

Services v. *Dublino*, 413 U.S. 405, 421 (1973) (citation omitted).[37]

This doctrine carries particular weight where the agency is contemporaneously construing newly enacted legislation:

> "Particularly is this respect due when the administrative practice at stake 'involves a contemporaneous construction of a statute by the men charged with the responsibility of setting its machinery in motion, of making the parts work efficiently and smoothly while they are yet untried and new.' " *Power Reactor Development Co.* v. *International Union of Electrical, Radio and Machine Workers*, 367 U.S. 396, 408 (1961) (citation omitted).

Even if the court below had another reasonable construction, its rejection of the interpretation given by FERC was antithetical to the doctrine enunciated by this Court in *Train* v. *Natural Resources Defense Council*, 421 U.S. 60, 87 (1975):

> "We therefore conclude that the Agency's interpretation of [separate provisions of the statute] was 'correct,' to the extent that it can be said with complete assurance that any particular interpretation of a complex statute such as this is the 'correct' one. Given this conclusion, as well as the facts that the Agency is charged with administration of the Act, and that there has undoubtedly been reliance upon its interpretation by the States and other parties affected by the Act, we have no doubt whatever that its construction was sufficiently reasonable to preclude the Court of Appeals from substituting its judgment for that of the Agency."[38]

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37 *See also Udall* v. *Tallman*, 380 U.S. 1, 16 (1965) ("this Court shows great deference to the interpretation given the statute by the officers or agency charged with its administration").

38 *See also Unemployment Compensation Commission* v. *Aragon*, 329 U.S. 143, 153 (1946) ("To sustain the Commission's application of this statutory term, we need not find that its construction is the only

The decision below, however, has construed PURPA § 210(e) in a manner which unreasonably denies FERC the very power Congress so obviously sought to give it. The Court of Appeals' ruling necessarily imputes to Congress the contradictory intention to encourage cogeneration and small power production with one hand in PURPA § 210(a) and (e)(1), and to stifle it with the other in § 210(e)(3)(B).[39]

The panel opinion thus effectively disregards the long-established rule that "every part of a statute must be construed in connection with the whole, so as to make all the parts harmonize, if possible, and give meaning to each." *Washington Market Co.* v. *Hoffman*, 101 U.S. 112, 116 (1879). The panel insisted that Congress had to grant express authority to order interconnection by rule before it would uphold the Commission. In so doing, it failed to recognize this Court's acknowledgment in *Mourning* v. *Family Publications Service, Inc.*, 411 U.S. 356, 372-73 (1973), that it was not:

> " 'a reasonable canon of interpretation that the draftsmen of acts delegating agency powers, as a practical and realistic matter, can or do include specific consideration

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reasonable one, or even that it is the result we would have reached had the question arisen in the first instance in judicial proceedings").

To date over 34 state utility commissions have completed the process of implementing the FERC rules. This process has been extremely time consuming and in some cases in spite of determined utility opposition. An affirmance of the opinion below will require dismantling these rules. *See Cogeneration and Small Power Production: Hearings on H.R. 6500 Before the Subcomm. on Energy Conservation and Power of the House Comm. on Energy and Commerce*, 97th Cong., 2d Sess. 314 (1982) (statement of Michael J. Zimmer, counsel, Cogeneration Coalition, Inc.)

39 Absent interconnection, purchases of power cannot occur, yet the Court of Appeals panel itself recognized that "one of the most basic purposes of PURPA was to remove the obstacle to cogeneration involved here: utilities were often unwilling to purchase the electric output at all or at an appropriate rate from cogenerators." B-18-19 (footnote omitted).

> of every evil sought to be corrected. . . . [N]o great acquaintance with practical affairs is required to know that such prescience, either in fact or in the minds of Congress, does not exist. Its very absence, moreover, is precisely one of the reasons why regulatory agencies such as the Commission are created, for it is the fond hope of their authors that they bring to their work the expert's familiarity with industry conditions which members of the delegating legislatures cannot be expected to possess.' " [*citing American Trucking Ass'ns* v. *United States*, 344 U.S. 298, 309-10 (1953)].

The "true rule," this Court stated in *Iglehart* v. *Iglehart*, 204 U.S. 478, 484-85 (1907):

> "is to harmonize the whole code, if possible, and to that end the letter of any particular section may sometimes be disregarded in order to accomplish the plain intention of the legislature. Effect must be given to all the language employed, and inconsistent expressions are to be harmonized to reach the real intent of the legislature."

C. The Commission's Interconnection Rule is Essential to Encourage Development of Alternative Energy Facilities

It is self-evident that no purchase or sale transaction can occur unless the qualifying facility is interconnected with the utility's system. Congress' direction to prescribe rules which FERC determines necessary to require utilities to offer to purchase electricity from qualifying facilities is empty verbiage, unless qualifying facilities have, or can promptly secure, a right to interconnection. Successfully carrying out the Congressional mandate depends, both conceptually and pragmatically, on establishing such a right by rule, rather than through individual adversarial proceedings between qualifying facilities and utilities conducted before the Commission. The rule ultimately prescribed by FERC is perfectly suited to Congress' purpose: it requires utilities only to "make such interconnections with any qualifying facility as may be necessary to

accomplish purchases or sales under [these rules]." 18 C.F.R. § 292. 303(c)(1).

During the rulemaking proceedings, a record was developed showing the obvious: financial considerations are crucial in producers' decisions whether to proceed. Under the rules promulgated by FERC, the costs of the physical interconnection must be borne by the qualifying facility. 18 C.F.R. § 292.306. Those costs, as was recognized during the rulemaking proceedings, can be substantial. R 2660.[40]

The expense of interconnection is compounded, however, when, as the court below would have it, a facility already qualifying under the rules' standards or by certification in advance is required to prosecute successfully an interconnection proceeding before FERC under the procedural requirements of FPA §§ 210 and 212.[41] The regulatory procedure required by those sections offers a tremendous potential for abuse through protracted litigation and delay by utilities that wish to inhibit the development of cogeneration and small power production in their service area.[42] The mere possibility

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40 According to Order No. 69, these costs include "costs of connection, switching, metering, transmission, distribution, safety provisions and administrative costs," B-45, and "may include, but are not limited to, operating and maintenance expenses [related to the interconnection], the costs of installation of equipment elsewhere on the utility's system necessitated by the interconnection, and reasonable insurance expenses." B-46.

41 At the present time, the cost to FERC of a contested interconnection proceeding amounts to over $57,000. FERC Notice of Proposed Rulemaking dated September 1, 1982, Docket No. RM 82-38-000, Fees Applicable to Electric Utilities, Cogenerators, and Small Power Producers, at 29-30. Rules presently being considered by the Commission would require an applicant for such an order to pay that sum in advance. *Id.* at 53-54.

42 An interconnection case was before the Commission at the time the review was in progress in the court below. It had been in administrative pretrial hearings for two and a half years at that time. *Central Power & Light Co., et al.*, Docket No. EL79-8. *See* Brief for Respondent Federal Energy Regulatory Commission in *American Electric Power Service Corp., et al.* v. *FERC, et al.*, 675 F.2d 1226 (D.C. Cir. 1982), at 69, n. 80.

that a utility, skilled and resourceful in the ways of regulatory procedure and litigation, may force delays and multiply expenses by contesting an application for interconnection, will magnify the potential developer's perceived risks to the degree that only in the most unusual circumstances would this investment option remain attractive.

Although the panel below suggested that proceedings under FPA §§ 210 and 212 may be "streamlined," it acknowledged that even streamlined procedures may be "too burdensome." B-23. The dissenters from denial of rehearing below noted that it was not apparent how the requirement of an evidentiary hearing could be obviated.[43] B-208, n.3. The inescapable burden placed by the panel's statutory interpretation on would-be developers of qualifying facilities would negate Congress' direction to FERC to encourage alternate energy sources by rule. It would give utilities a powerful tool with which they could hinder, delay and ultimately extract onerous terms from project developers, just as they were able to do before PURPA became law.[44] Of a certainty such a prospect would have a

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43 The panel did not explain under what authority such "streamlining" is permissible in the face of the statutory definition of "evidentiary hearings" and "evidentiary proceeding" as "a proceeding conducted as provided in sections 554, 556 and 557 of Title 5." 16 U.S.C. § 796(20) (1976 ed., Supp. III).

44 One legislator noted in hearings leading to PURPA that:

> "Many electric companies have been willing to interconnect with small producers, but offer unfair rates. For example, one manufacturer of interconnect equipment reports seventy windmills, hydro systems, and photovoltaic arrays use its machinery to connect with electric utilities. The company reports that in two-thirds of these cases, the electric company will accept power from small producers but does not pay for it. Other companies have offered to pay only very low rates—less than the costs of fuel to their least costly generating plants. This is certainly less than the electricity is worth. An ERDA official reports that utilities whose industrial customers produce power generally refuse to purchase surplus power."

Public Utility Rate Proposals of President Carter's Energy Program: Hearings on S. 122, S. 1300, S. 1363, S. 1364 and S. 1469 (Part E) before the Subcomm. on Energy Conservation and Regulation of the Senate Comm. on Energy and Natural Resources, 95th Cong., 1st Sess. 385-86 (1977) (statement of Senator Charles Percy).

substantial chilling effect on the program envisioned by Congress in § 210 of PURPA.

Simply put, the decision of the Court of Appeals will mean that most qualifying facilities will be able to sell to or purchase from a utility only if the utility is willing—precisely the situation which prevailed prior to PURPA. Hence, PURPA § 210's theoretical assurance of a market for sales of power will provide no practical benefit or encouragement.

CONCLUSION

The Commission complied with PURPA when it issued its rule for the purchase of energy from new qualifying cogeneration and small power production facilities based upon a utility's avoided costs. It properly interpreted and applied the statutory mandate in doing so, and was neither arbitrary nor capricious. The Commission's rule requiring utilities to interconnect with qualifying facilities in order to make possible purchases and sales was well within its authority. In setting aside those rules, the Court of Appeals erred in disregarding established limitations on judicial review of agency actions. For these reasons the judgment of the Court of Appeals should be reversed and the rules of the Federal Energy Regulatory Commission should be reinstated.

Respectfully submitted,

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December 6, 1982

Listing of Parent Companies, Subsidiaries and Affiliates of Petitioner

The American Paper Institute, Inc. is a non-profit national trade association of the pulp, paper and paperboard manufacturing industry, whose 163 member companies, and their divisions, subsidiaries and affiliates primarily engaged in the manufacture of pulp, paper and paperboard products are listed below. This list does not include (in the case of diversified member companies) divisions, subsidiaries or affiliates primarily engaged in other businesses.

Alabama River Pulp Company, Inc.
  Subsidiary of Parsons & Whittemore, Inc.
American Can Company
American Convenience Products, Inc.
Amricon Corporation
Appleton Papers, Inc.
  Subsidiary of B.A.T. Industries
Augusta Newsprint Company
Banner Fibreboard Company
Bay West Paper Company
Bear Island Paper Company
Blandin Paper Company
Boise Cascade Corporation
Bowater North America Corporation
Burrows Paper Corporation
J.D. Cahill Company, Inc.
Caraustar Industries, Inc.
  Subsidiaries:
    Ashuelot Paper Company, Inc.
    Austell Box Board Corporation
    Carolina Paper Board Corporation
    Carotell Paper Board Corporation
    Sweetwater Paper Board Company

Chicopee
Division of Johnson & Johnson
Champion International Corporation
The Chesapeake Corporation of Virginia
Cleaners Hanger Company
Clevepak Corporation
The Columbia Corporation
Consolidated Packaging Corporation
Consolidated Papers, Inc.
Container Corporation of America
Subsidiary of Mobil Corporation
The Continental Group, Inc., Continental
Forest Industries
Cottrell Paper Company, Inc.
CPM, Inc.
Crane & Company, Inc.
Subsidiary:
Byron Weston Company
Crown Paper Board Company, Inc.
Crown Zellerbach Corporation
The Crystal Tissue Company
Deerfield Specialty Papers, Inc.
The Dexter Corporation
Diamond International Corporation
Domtar Fine Papers
Dunn Paper Company
Subsidiary of Dennison Mfg. Company
Eastern Fine Paper, Inc.
Division of E.B. Eddy Forest Products, Ltd.
Eastex Division Temple-Eastex, Inc.
Subsidiary of Time, Inc.
Ecusta Paper & Film Group Olin Corporation
Equitable Bag Company, Inc.
Erving Paper Mills
Esleek Manufacturing Company
Exton Paper Manufacturers, Inc.
Federal Paper Board Company, Inc.
Fibre Leather Manufacturing Corporation

Finch, Pruyn & Company, Inc.
Flambeau Paper Corporation
Subsidiary of Pentair, Inc.
Fletcher Paper Company
Fortifiber Corporation
Foster Paper Company
Fox River Paper Company
Fraser Paper, Limited
French Paper Company
FSC Paper Corporation
Subsidiary of Field Enterprises, Inc. and Media General, Inc.
Garden State Paper Company, Inc.
Affiliate of Media General, Inc.
Georgia-Pacific Corporation
Gilman Paper Company
P.H. Glatfelter Company
W.R. Grace & Company
Great Northern Nekoosa Corporation
Green Bay Packaging, Inc.
Greif Board Corporation
Gulf States Paper Corporation
Halltown Paperboard Company
Hammermill Paper Company
Hampden Papers, Inc.
Harriman Paperboard Company
Hazen Paper Company
Heller and Usdan, Inc.
Hercules Inc.
Hoffmaster Company, Inc.
Hollingsworth & Vose Company
Holliston Mills, Inc.
Holyoke Card & Paper Company
Inland Container Corporation
Subsidiary of Time, Inc.
Inland Empire Paper Company
International Paper Company

ITT Rayonier, Inc.
James River Corporation of Virginia
Jen-Coat, Inc.
Keyes Fibre Company
Kieffer Paper Mills, Inc.
Lawrence Paperboard Corporation
Linweave, Inc.
Litton Industries, Inc.
Longview Fibre Company
Louisiana-Pacific Corporation
Lowe Paper Company
Ludlow Corporation
Lydall Inc.
MacMillan Bloedel, Inc.
Madison Paper Corporation
McIntyre Bros. Paper Company, Inc.
Manistique Pulp & Paper Company
  Subsidiary of Field Enterprises, Inc.
Manville Forest Products Corporation
  Subsidiary of Johns-Manville Corporation
Marcal Paper Mills, Inc.
The Mead Corporation
Menasha Corporation
Menominee Paper Co., Inc.
  Subsidiary of Bell Fibre Products Corporation
Merrimac Paper Company, Inc.
Midtec Paper Corporation
Millers Falls Paper Company
Missisquoi
Mohawk Paper Mills, Inc.
Monadnock Paper Mills, Inc.
Morris Paper Board Company
  Division of Berlis Carton Company, Inc.
Mosinee Paper Corporation
National Gypsum Company
The Newark Group
  Subsidiaries:
    California Paperboard Corporation

Connecticut Paperboard Corporation
Haverhill Paperboard Corporation
Middletown Paperboard Corporation
Natick Paperboard Corporation
Newark Boxboard Company
Wisconsin Paperboard Corporation
Newman & Company, Inc.
Newton Falls Paper Mill, Inc.
Nicolet Paper Company
Subsidiary of Philip Morris, Inc.
Nitec Paper Company
Onduline U.S.A., Inc.
Orchids Paper Products-Concel, Inc.
Subsidiary of APL Corporation
Owens-Illinois, Inc.
Packaging Corporation of America
Division of Tenneco, Inc.
Paper Art Company, Inc.
Paper Products, Inc.
Parsons Paper Division, The NVF Company
Pejepscot Paper Division, The Hearst Corporation
Penntech Papers, Inc.
Pentair, Inc.
Plainwell Paper Company, Inc.
Subsidiary of Philip Morris, Inc.
Pope & Talbot, Inc.
Port Huron Paper Company
Potlatch Corporation
Potsdam Paper Company
The Procter & Gamble Company
Subsidiary:
The Buckeye Cellulose Corporation
The Quaker Oats Company
Riegel Textile Corporation
Rising Paper Company
Rock-Tenn Company
St. Joe Paper Company
St. Regis Paper Company

Scott Paper Company
  Affiliate:
    Brunswick Pulp & Paper Company
Seaman Paper Company of Massachusetts, Inc.
Shawano Paper Mills
Simpson Paper Co.
  Subsidiary of Simpson Timber Company
H.P. Smith Paper Company
Sonoco Products Company
The Sorg Paper Company
Southeast Paper Manufacturing Company
Southwest Forest Industries, Inc.
Southworth Company
Springprint Paper Products Co.
Stevens & Thompson Paper Company
  Division of Dixico Inc.
Stirling Converting Company, Inc.
Stone Container Corporation
Sullivan Paper Company
Tagsons Papers, Inc.
The Tuttle Press Company
  Division of Fox Valley Corporation
Union Camp Corporation
Virginia Fibre Corporation
West Carrollton Parchment Company
Weston Paper and Manufacturing Company, Inc.
Westvaco Corporation
Weyerhaeuser Company
Whitestone Products
  Division of IPCO Hospital Supply Corporation
Willamette Industries, Inc.
Wisconsin Tissue Mills, Inc.
  Affiliate of Philip Morris, Inc.
Yorktowne Paper Mills, Inc.
  Subsidiary: Yorktowne Paper Mills of Maine

STATUTORY AND REGULATORY PROVISIONS INVOLVED

Statutory Provisions

Section 210 of PURPA provides (16 U.S.C. § 824a-3):

(a) COGENERATION AND SMALL POWER PRODUCTION RULES Not later than 1 year after the date of enactment of this Act, the Commission shall prescribe, and from time to time thereafter revise, such rules as it determines necessary to encourage cogeneration and small power production which rules require electric utilities to offer to—

(1) sell electric energy to qualifying cogeneration facilities and qualifying small power production facilities and

(2) purchase electric energy from such facilities.

Such rules shall be prescribed, after consultation with representatives of Federal and State regulatory agencies having ratemaking authority for electric utilities, and after public notice and a reasonable opportunity for interested persons (including State and Federal agencies) to submit oral as well as written data, views, and arguments. Such rules shall include provisions respecting minimum reliability of qualifying cogeneration facilities and qualifying small power production facilities (including reliability of such facilities during emergencies) and rules respecting reliability of electric energy service to be available to such facilities from electric utilities during emergencies. Such rules may not authorize a qualifying cogeneration facility or qualifying small power production facility to make any sale for purposes other than resale.

(b) RATES FOR PURCHASES BY ELECTRIC UTILITIES The rules prescribed under subsection (a) shall insure that, in

requiring any electric utility to offer to purchase electric energy from any qualifying cogeneration facility or qualifying small power production facility, the rates for such purchase—

(1) shall be just and reasonable to the electric consumers of the electric utility and in the public interest, and

(2) shall not discriminate against qualifying cogenerators or qualifying small power producers.

No such rule prescribed under subsection (a) shall provide for a rate which exceeds the incremental cost to the electric utility of alternative electric energy.

(c) RATES FOR SALES BY UTILITIES The rules prescribed under subsection (a) shall insure that, in requiring any electric utility to offer to sell electric energy to any qualifying cogeneration facility or qualifying small power production facility, the rates for such sale—

(1) shall be just and reasonable and in the public interest, and

(2) shall not discriminate against the qualifying cogenerators or qualifying small power producers.

(d) DEFINITION For purposes of this section, the term "incremental cost of alternative electric energy" means, with respect to electric energy purchased from a qualifying cogenerator or qualifying small power producer, the cost to the electric utility of the electric energy which, but for the purchase from such cogenerator or small power producer, such utility would generate or purchase from another source.

(e) EXEMPTIONS (1) Not later than 1 year after the date of enactment of this Act and from time to time thereafter, the Commission shall, after consultation with representatives of State regulatory authorities, electric utilities, owners of cogeneration facilities and owners of small power production facilities, and after public notice and a reasonable opportunity for interested persons (including State and Federal agencies) to submit oral as well as written data, views, and arguments,

prescribe rules under which qualifying cogeneration facilities and qualifying small power production facilities are exempted in whole or part from the Federal Power Act, from the Public Utility Holding Company Act, from State laws and regulations respecting the rates, or respecting the financial or organizational regulation, of electric utilities, or from any combination of the foregoing, if the Commission determines such exemption is necessary to encourage cogeneration and small power production.

(2) No qualifying small power production facility which has a power production capacity which, together with any other facilities located at the same site (as determined by the Commission), exceeds 30 megawatts may be exempted under rules under paragraph (1) from any provision of law or regulation referred to in paragraph (1), except that any qualifying small power production facility which produces electric energy solely by the use of biomass as a primary energy source, may be exempted by the Commission under such rules from the Public Utility Holding Company Act and from State laws and regulations referred to in such paragraph (1).

(3) No qualifying small power production facility or qualifying cogeneration facility may be exempted under this subsection from—

(A) any State law or regulation in effect in a State pursuant to subsection (f),

(B) the provisions of section 210, 211, or 212 of the Federal Power Act or the necessary authorities for enforcement of any such provision under the Federal Power Act, or

(C) any license or permit requirement under part I of the Federal Power Act, any provision under such Act related to such a license or permit requirement, or the necessary authorities for enforcement of any such requirement.

(f) IMPLEMENTATION OF RULES FOR QUALIFYING COGENERATION AND QUALIFYING SMALL POWER PRODUCTION

FACILITIES (1) Beginning on or before the date one year after any rule is prescribed by the Commission under subsection (a) or revised under such subsection, each State regulatory authority shall, after notice and opportunity for public hearing, implement such rule (or revised rule) for each electric utility for which it has ratemaking authority.

(2) Beginning on or before the date one year after any rule is prescribed by the Commission under subsection (a) or revised under such subsection, each nonregulated electric utility shall, after notice and opportunity for public hearing, implement such rule (or revised rule).

(g) JUDICIAL REVIEW AND ENFORCEMENT (1) Judicial review may be obtained respecting any proceeding conducted by a State regulatory authority or nonregulated electric utility for purposes of implementing any requirement of a rule under subsection (a) in the same manner, and under the same requirements, as judicial review may be obtained under section 123 in the case of a proceeding to which section 123 applies.

(2) Any person (including the Secretary) may bring an action against any electric utility, qualifying small power producer, or qualifying cogenerator to enforce any requirement established by a State regulatory authority or nonregulated electric utility pursuant to subsection (f). Any such action shall be brought only in the manner, and under the requirements, as provided under section 123 with respect to an action to which section 123 applies.

(h) COMMISSION ENFORCEMENT (1) For purposes of enforcement of any rule prescribed by the Commission under subsection (a) with respect to any operations of an electric utility, a qualifying cogeneration facility or a qualifying small power production facility which are subject to the jurisdiction of the Commission under part II of the Federal Power Act, such rule shall be treated as a rule under the Federal Power Act. Nothing in subsection (g) shall apply to so much of the operations of an electric utility, a qualifying cogeneration facility or a qualifying small power production facility as are

subject to the jurisdiction of the Commission under part II of the Federal Power Act.

(2)(A) The Commission may enforce the requirements of subsection (f) against any State regulatory authority or nonregulated electric utility. For purposes of any such enforcement, the requirements of subsection (f)(1) shall be treated as a rule enforceable under the Federal Power Act. For purposes of any such action, a State regulatory authority or nonregulated electric utility shall be treated as a person within the meaning of the Federal Power Act. No enforcement action may be brought by the Commission under this section other than—

(i) an action against the State regulatory authority or nonregulated electric utility for failure to comply with the requirements of subsection (f) or

(ii) an action under paragraph (1).

(B) Any electric utility, qualifying cogenerator, or qualifying small power producer may petition the Commission to enforce the requirements of subsection (f) as provided in subparagraph (A) of this paragraph. If the Commission does not initiate an enforcement action under subparagraph (A) against a State regulatory authority or nonregulated electric utility within 60 days following the date on which a petition is filed under this subparagraph with respect to such authority, the petitioner may bring an action in the appropriate United States district court to require such State regulatory authority or nonregulated electric utility to comply with such requirements, and such court may issue such injunctive or other relief as may be appropriate. The Commission may intervene as a matter of right in any such action.

(i) FEDERAL CONTRACTS No contract between a Federal agency and any electric utility for the sale of electric energy by such Federal agency for resale which is entered into after the date of the enactment of this Act may contain any provision which will have the effect of preventing the implementation of any rule under this section with respect to such utility. Any

provision in any such contract which has such effect shall be null and void.

(j) DEFINITIONS For purposes of this section, the terms "small power production facility," "qualifying small power production facility," "qualifying small power producer," "primary energy source," "cogeneration facility," "qualifying cogeneration facility," and "qualifying cogenerator" have the respective meanings provided for such terms under section 3 (17) and (18) of the Federal Power Act.

Section 210 of the Federal Power Act provides (16 U.S.C. § 824i):

(a) POWERS OF COMMISSION; APPLICATION BY STATE REGULATORY AUTHORITY (1) Upon application of any electric utility, Federal power marketing agency, qualifying cogenerator, or qualifying small power producer, the Commission may issue an order requiring—

(A) the physical connection of any cogeneration facility, any small power production facility, or the transmission facilities of any electric utility, with the facilities of such applicant,

(B) such action as may be necessary to make effective any physical connection described in subparagraph (A), which physical connection is ineffective for any reason, such as inadequate size, poor maintenance, or physical unreliability,

(C) such sale or exchange of electric energy or other coordination, as may be necessary to carry out the purposes of any order under subparagraph (A) or (B), or

(D) such increase in transmission capacity as may be necessary to carry out the purposes of any order under subparagraph (A) or (B).

(2) Any State regulatory authority may apply to the Commission for an order for any action referred to in subparagraph (A), (B), (C), or (D) of paragraph (1). No such order may be issued by the Commission with respect to a Federal power marketing agency upon application of a State regulatory authority.

(b) NOTICE, HEARING AND DETERMINATION BY COMMISSION Upon receipt of an application under subsection (a) of this section, the Commission shall—

(1) issue notice to each affected State regulatory authority, each affected electric utility, each affected Federal power marketing agency, each affected owner or operator of a cogeneration facility or of a small power production facility, and to the public.

(2) afford an opportunity for an evidentiary hearing, and

(3) make a determination with respect to the matters referred to in subsection (c) of this section.

(c) NECESSARY FINDINGS No order may be issued by the Commission under subsection (a) of this section unless the Commission determines that such an order—

(1) is in the public interest,

(2) would—

(A) encourage overall conservation of energy or capital,

(B) optimize the efficiency of use of facilities and resources, or

(C) improve the reliability of any electric utility system or Federal power marketing agency to which the order applies, and

(3) meets the requirements of section 824k [FPA § 212] of this title.

(d) MOTION OF COMMISSION The Commission may, on its own motion, after compliance with the requirements of paragraphs (1) and (2) of subsection (b) of this section, issue an order requiring any action described in subsection (a)(1) of this section if the Commission determines that such order meets the requirements of subsection (c) of this section. No such order may be issued upon the Commission's own motion with respect to a Federal power marketing agency.

(e) DEFINITIONS (1) As used in this section, the term "facilities" means only facilities used for the generation or transmission of electric energy.

(2) With respect to an order issued pursuant to an application of a qualifying cogenerator or qualifying small power producer under subsection (a)(1) of this section, the term "facilities of such applicant" means the qualifying cogeneration facilities or qualifying small power production facilities of the applicant, as specified in the application. With respect to an order issued pursuant to an application under subsection (a)(2) of this section, the term "facilities of such applicant" means the qualifying cogeneration facilities, qualifying small power production facilities, or the transmission facilities of an electric utility, as specified in the application. With respect to an order issued by the Commission on its own motion under subsection (d) of this section, such term means the qualifying cogeneration facilities, qualifying small power production facilities, or the transmission facilities of an electric utility, as specified in the proposed order.

Section 212 of the Federal Power Act provides (16 U.S.C. § 824k):

(a) DETERMINATIONS BY COMMISSION No order may be issued by the Commission under section 824i [FPA § 210] or subsection (a) or (b) of section 824j [FPA § 211] of this title unless the Commission determines that such order—

(1) is not likely to result in a reasonably ascertainable uncompensated economic loss for any electric utility, qualifying cogenerator, or qualifying small power producer, as the case may be, affected by the order;

(2) will not place an undue burden on an electric utility, qualifying cogenerator, or qualifying small power producer, as the case may be, affected by the order;

(3) will not unreasonably impair the reliability of any electric utility affected by the order; and

(4) will not impair the ability of any electric utility affected by the order to render adequate service to its customers.

The determination under paragraph (1) shall be based upon a showing of the parties. The Commission shall have no authority under section 824i or 824j of this title to compel the enlargement of generating facilities.

(b) REIMBURSEMENT OF PARTIES SUBJECT TO ORDERS No order may be issued under section 824i or subsection (a) or (b) of section 824j of this title unless the applicant for such order demonstrates that he is ready, willing, and able to reimburse the party subject to such an order for—

(1) in the case of an order under section 824i of this title, such party's share of the reasonably anticipated costs incurred under such order, and

(2) in the case of an order under subsection (a) or (b) of section 824j of this title—

(A) the reasonable costs of transmission services, including the costs of any enlargement of transmission facilities, and

(B) a reasonable rate of return on such costs, as appropriate, as determined by the Commission.

(c) ISSUANCE OF PROPOSED ORDER; AGREEMENT BY PARTIES TO TERMS AND CONDITIONS OF ORDER; APPROVAL BY COMMISSION; INCLUSION IN FINAL ORDER; FAILURE TO AGREE (1) Before issuing an order under section 824i or subsection (a) or (b) of section 824j of this title, the Commission shall issue a proposed order and set a reasonable time for parties to the proposed interconnection or transmission order to agree to terms and conditions under which such order is to be carried out, including the apportionment of costs between them and the compensation or reimbursement reasonably due to any of them. Such proposed order shall not be reviewable or enforceable in any court. The time set for such parties to agree to such terms and conditions may be shortened if the Commission determines that delay would jeopardize the attainment of the purposes of any proposed order. Any terms and conditions agreed to by the parties shall be subject to the approval of the Commission.

(2)(A) If the parties agree as provided in paragraph (1) within the time set by the Commission and the Commission approves such agreement, the terms and conditions shall be included in the final order. In the case of an order under section 824i of this title, if the parties fail to agree within the time set by the Commission or if the Commission does not approve any such agreement, the Commission shall prescribe such terms and conditions and include such terms and conditions in the final order.

(B) In the case of any order applied for under section 824j of this title, if the parties fail to agree within the time set by the Commission, the Commission shall prescribe such terms and conditions in the final order.

Statement of reasons for denial

(d) If the Commission does not issue any order applied for under section 824i or 824j of this title, the Commission shall, by order, deny such application and state the reasons for such denial.

(e) UTILIZATION OF INTERCONNECTION OR WHEELING AUTHORITY IN LIEU OF OTHER AUTHORITY; LIMITATION OF COMMISSION AUTHORITY No provision of section 824i or 824j of this title shall be treated—

(1) as requiring any person to utilize the authority of such section 824i or 824j of this title in lieu of any other authority of law, or

(2) as limiting, impairing, or otherwise affecting any authority of the Commission under any other provision of law.

(f) EFFECTIVE DATE OF ORDER; HEARING; NOTICE; REVIEW (1) No order under section 824i or 824j of this title requiring the Tennessee Valley Authority (hereinafter in this subsection referred to as the "TVA") to take any action shall take effect for 60 days following the date of issuance of the order. Within 60 days following the issuance by the Commission of any order under section 824i or of section 824j of this title requiring the TVA to enter into any contract for the sale or delivery of power, the Commission may on its own motion initiate, or upon petition of any aggrieved person shall initiate, an evidentiary hearing to determine whether or not such sale or delivery would result in violation of the third sentence of section 15d(a) of the Tennessee Valley Authority Act of 1933, hereinafter in this subsection referred to as the TVA Act.

(2) Upon initiation of any evidentiary hearing under paragraph (1), the Commission shall give notice thereof to any applicant who applied for and obtained the order from the Commission, to any electric utility or other entity subject to

such order, and to the public, and shall promptly make the determination referred to in paragraph (1). Upon initiation of such hearing, the Commission shall stay the effectiveness of the order under section 824i or 824j of this title until whichever of the following dates is applicable—

(A) the date on which there is a final determination (including any judicial review thereof under paragraph (3)) that no such violation would result from such order, or

(B) the date on which a specific authorization of the Congress (within the meaning of the third sentence of section 15d(a) of the TVA Act) takes effect.

(3) Any determination under paragraph (1) shall be reviewable only in the appropriate court of the United States upon petition filed by any aggrieved person or municipality within 60 days after such determination, and such court shall have jurisdiction to grant appropriate relief. Any applicant who applied for and obtained the order under section 824i or 824j of this title, and any electric utility or other entity subject to such order shall have the right to intervene in any such proceeding in such court. Except for review by such court (and any appeal or other review by an appellate court of the United States), no court shall have jurisdiction to consider any action brought by any person to enjoin the carrying out of any order of the Commission under section 824i or section 824j of this title requiring the TVA to take any action on the grounds that such action requires a specific authorization of the Congress pursuant to the third sentence of section 15d(a) of the TVA Act.

Regulatory Provisions

The Federal Energy Regulatory Commission's definition of "Avoided costs" provides (18 C.F.R. § 292.101(b)(6)):

(6) "Avoided costs" means the incremental costs to an electric utility of electric energy or capacity or both which, but for the purchase from the qualifying facility or qualifying facilities, such utility would generate itself or purchase from another source.

The Federal Energy Regulatory Commission's "interconnection" rule provides (18 C.F.R. § 292.303(c)(1)):

(c) *Obligation to interconnect.* (1) Subject to paragraph (c)(2) of this section, any electric utility shall make such interconnections with any qualifying facility as may be necessary to accomplish purchases or sales under this subpart. The obligation to pay for any interconnection costs shall be determined in accordance with § 292.306.

The Federal Energy Regulatory Commission's "Rates for purchases" rule provides (18 C.F.R. § 292.304):

(a) *Rates for purchases.* (1) Rates for purchases shall:

(i) be just and reasonable to the electric consumer of the electric utility and in the public interest; and

(ii) not discriminate against qualifying cogeneration and small power production facilities.

(2) Nothing in this subpart requires any electric utility to pay more than the avoided costs for purchases.

(b) *Relationship to avoided costs.* (1) For purposes of this paragraph, "new capacity" means any purchase from capacity of a qualifying facility, construction of which was commenced on or after November 9, 1978.

(2) Subject to subparagraph (3), a rate for purchases satisfies the requirements of paragraph (a) if the rate equals the

avoided costs determined after consideration of the factors set forth in paragraph (e).

(3) A rate for purchases (other than from new capacity) may be less than the avoided cost if the State regulatory authority (with respect to any electric utility over which it has ratemaking authority) or the nonregulated electric utility determines that a lower rate is consistent with paragraph (a), and is sufficient to encourage cogeneration and small power production.

(4) Rates for purchases from new capacity shall be in accordance with subparagraph (2), regardless of whether the electric utility making such purchases is simultaneously making sales to the qualifying facility.

(5) In the case in which the rates for purchases are based upon estimates of avoided costs over the specific term of the contract or other legally enforceable obligation, the rates for such purchases do not violate this subpart if the rates for such purchases differ from avoided costs at the time of delivery.

(c) *Standard rates for purchases.* (1) There shall be put into effect (with respect to each electric utility) standard rates for purchases from qualifying facilities with a design capacity of 100 kilowatts or less.

(2) There may be put into effect standard rates for purchases from qualifying facilities with a design capacity of more than 100 kilowatts.

(3) The standard rates for purchases under this paragraph:

(i) shall be consistent with paragraphs (a) and (e); and

(ii) may differentiate among qualifying facilities using various technologies on the basis of the supply characteristics of the different technologies.

(d) *Purchases "as available" or pursuant to a legally enforceable obligation.* Each qualifying facility shall have the option either:

(1) to provide energy as the qualifying facility determines such energy to be available for such purchases, in which case the rates for such purchases shall be based on the purchasing utility's avoided costs calculated at the time of delivery; or

(2) to provide energy or capacity pursuant to a legally enforceable obligation for the delivery of energy or capacity over a specified term, in which case the rates for such purchases shall, at the option of the qualifying facility exercised prior to the beginning of the specified term, be based on either:

(i) the avoided costs calculated at the time of delivery; or

(ii) the avoided costs calculated at the time the obligation is incurred.

(e) *Factors affecting rates for purchases.* In determining avoided costs, the following factors shall, to the extent practicable, be taken into account:

(1) the data provided pursuant to § 292.302(b), (c), or (d), including State review of any such data;

(2) the availability of capacity or energy from a qualifying facility during the system daily and seasonal peak periods, including:

(i) the ability of the utility to dispatch the qualifying facility;

(ii) the expected or demonstrated reliability of the qualifying facility;

(iii) the terms of any contract or other legally enforceable obligation, including the duration of the obligation, termination notice requirement and sanctions for non-compliance;

(iv) the extent to which scheduled outages of the qualifying facility can be usefully coordinated with scheduled outages of the utility's facilities;

(v) the usefulness of energy and capacity supplied from a qualifying facility during system emergencies, including its ability to separate its load from its generation;

(vi) the individual and aggregate value of energy and capacity from qualifying facilities on the electric utility's system; and

(vii) the smaller capacity increments and the shorter lead times available with additions of capacity from qualifying facilities; and

(3) the relationship of the availability of energy or capacity from the qualifying facility as derived in subparagraph (2), to the ability of the electric utility to avoid costs, including the deferral of capacity additions and the reduction of fossil fuel use; and

(4) the costs or savings resulting from variations in line losses from those that would have existed in the absence of purchases from a qualifying facility, if the purchasing electric utility generated an equivalent amount of energy itself or purchased an equivalent amount of electric energy or capacity.

(f) *Periods during which purchases not required.*

(1) Any electric utility which gives notice pursuant to subparagraph (2) will not be required to purchase electric energy or capacity during any period during which, due to operational circumstances, purchases from qualifying facilities will result in costs greater than those which the utility would incur if it did not make such purchases, but instead generated an equivalent amount of energy itself.

(2) Any electric utility seeking to invoke subparagraph (1) must notify, in accordance with applicable State law or regulation, each affected qualifying facility in time for the qualifying facility to cease the delivery of energy or capacity to the electric utility.

(3) Any electric utility which fails to comply with the provisions of subparagraph (2) will be required to pay the same rate for such purchase of energy or capacity as would be required had the period described in subparagraph (1) not occurred.

(4) A claim by an electric utility that such a period has occurred or will occur is subject to such verification by its State regulatory authority as the State regulatory authority determines necessary or appropriate, either before or after the occurrence.

The Federal Energy Regulatory Commission's "Waivers" rule provides (18 C.F.R. § 292.403(a)):

(a) *State regulatory authority and nonregulated electric utility waivers.* Any State regulatory authority (with respect to any electric utility over which it has ratemaking authority) or nonregulated electric utility may, after public notice in the area served by the electric utility, apply for a waiver from the application of any of the requirements of Subpart C [§§ 292.301-.308] (other than § 292.302 thereof).

IN THE

Supreme Court of the United States

OCTOBER TERM, 1982

Nos. 82-34 and 82-226

AMERICAN PAPER INSTITUTE, INC.,
Petitioner

v.

AMERICAN ELECTRIC POWER SERVICE CORP., *et al.*,
Respondents

FEDERAL ENERGY REGULATORY COMMISSION,
Petitioner

v.

AMERICAN ELECTRIC POWER SERVICE CORP., *et al.*,
Respondents

On Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

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BRIEF FOR RESPONDENT ELECTRIC UTILITIES

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January 11, 1983

QUESTIONS PRESENTED

This case concerns the validity of rules promulgated by the Federal Energy Regulatory Commission under section 210 of the Public Utility Regulatory Policies Act of 1978 (PURPA). The questions presented are:

1. Whether the FERC's rule which requires utilities to offer to purchase power from qualifying cogeneration and small power production facilities at the utility's "full avoided cost" comports with the statutory standards set forth in section 210(b) of PURPA and whether the FERC adequately justified its rule in light of the statutory criteria.

2. Whether the FERC's blanket exemption of qualifying facilities from the interconnection provisions of Federal Power Act sections 210 and 212 (added to the Federal Power Act by PURPA) violates PURPA section 210(e)(3)(B), which prohibits the FERC from exempting qualifying facilities from these provisions.

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Resource Planning Associates, *The Potential for Cogeneration Development in Six Major Industries by 1985* (1977) 27

S. 1469, 95th Cong., 1st Sess. (1977):

Section 521 ..... 38, 39

Section 522 ..... 38, 39

IN THE

Supreme Court of the United States

OCTOBER TERM, 1982

Nos. 82-34 and 82-226

AMERICAN PAPER INSTITUTE, INC.,
Petitioner

v.

AMERICAN ELECTRIC POWER SERVICE CORP., *et al.*,
Respondents

FEDERAL ENERGY REGULATORY COMMISSION,
Petitioner

v.

AMERICAN ELECTRIC POWER SERVICE CORP., *et al.*,
Respondents

On Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

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BRIEF FOR RESPONDENT ELECTRIC UTILITIES

STATEMENT OF THE CASE

A. The Statute

The Public Utility Regulatory Policies Act (PURPA or the Act) is one part of the complex of five major statutes enacted in 1978 and known jointly as the National Energy Act. As this Court observed in *FERC v. Mississippi*, 102 S.Ct. 2126, 2132 (1982), "Congress believed that increased use of [cogeneration and small power production facilities] would reduce the demand for traditional fossil fuels," especially oil and natural gas. Congress, through PURPA, sought (1) to increase the efficiency with which the nation employs its scarce energy-related resources and (2) to provide rate protection to

consumers. PURPA § 2(1), 16 U.S.C. § 2601(1) (Supp. V).

Both the Administration and Congress perceived that two institutional barriers were impeding the development of otherwise justified cogeneration projects.[1] First, some utilities, it was believed, discouraged cogeneration by refusing (i) to buy the cogenerator's surplus power or to do so at reasonable rates or (ii) to provide, at reasonable rates, the back-up power the cogenerator might require. The second barrier was regulatory: under then-existing law, any cogenerator which sold surplus power might be deemed a "utility" and thereby become subject to intrusive and burdensome utility-related statutes and regulations.

The cogeneration provisions of PURPA were designed to eliminate these barriers and thereby permit cogeneration to add to the nation's energy resources in a way that is fair both to cogenerators which qualify for the benefits of the Act (so-called "qualifying facilities") and to utility ratepayers. The Act eliminated the first barrier (1) by requiring utilities to purchase cogenerated power and to sell cogenerators the additional power they need, each at reasonable rates, and (2) by authorizing qualifying cogenerators to apply to the Federal Energy Regulatory Commission (FERC or Commission) for orders permitting interconnection with utilities.

To assure that rates by which utilities purchase power from cogenerators (referred to as "purchase rates") would be fair, Congress mandated particular standards that the FERC was to follow in promulgating the rules pursuant to which the States would set purchase rates. Under section 210(b) of PURPA, 16 U.S.C. § 824a-3(b)

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[1] As used herein, "cogeneration" refers to both cogeneration and small power production under PURPA.

The listing of all parents and affiliates of the Respondent Electric Utilities required by Rule 28.1 appears in Appendix A to the Brief of Respondents in Opposition to the petitions for writs of certiorari in Dkt. Nos. 82-34 and 82-226.

(Supp. V), purchase rates "shall be just and reasonable to the electric consumers of the electric utility and in the public interest, and . . . shall not discriminate against qualifying [facilities]." Congress also included an express limitation: no purchase rate rule "shall provide for a rate which exceeds the incremental cost to the electric utility of alternative electric energy." *Id.*

Congress recognized that a qualifying facility could not sell power to a utility unless it could "interconnect" its facility with the purchasing utility. To permit this, in PURPA it amended the Federal Power Act (FPA) by adding sections 210 and 212, 16 U.S.C. §§ 824i, 824k (Supp. V), which authorize qualifying facilities to obtain orders for such interconnections, under specified conditions, from the FERC. PURPA §§ 202, 204.

To eliminate the second barrier to cogeneration, that of overly intrusive regulation, Congress gave the FERC broad authority, in section 210(e) of PURPA, 16 U.S.C. §§ 824a-3(e) (Supp V), to exempt qualifying facilities from certain federal and state regulatory requirements. However, in PURPA section 210(e)(3)(B), 16 U.S.C. § 824a-3(e)(3)(B) (Supp. V), it expressly prohibited the FERC from exempting qualifying facilities from the interconnection provisions of sections 210 and 212 of the FPA.

B. The Commission's Rules

The Commission ordered state commissions to set purchase rates for qualifying facilities built after the enactment of the statute at a level equal to the utility's "full avoided cost." 18 C.F.R. § 292.304. The rule defines "full avoided cost" as equivalent to the statutory ceiling for purchase rates (*i.e.*, "incremental cost"), meaning the full cost which the utility would have incurred had it provided the power on its own. *Id.* at § 292.101(b)(6). The effect of the rule is to deny any share of the potential rate savings to the consumers of the participating utility, despite section 210(b)'s direction that rates be "just and

reasonable to the electric consumers." In its "interconnection rule," 18 C.F.R. § 292.303(c), the Commission exempted all qualifying facilities from the requirements of FPA sections 210 and 212, and ordered interconnections on a blanket basis, despite the exemption limitation of PURPA section 210(e)(3)(B).

C. The Decision of the Court of Appeals

The court of appeals considered four challenges to the FERC's cogeneration rules. In a unanimous opinion written by Judge Wilkey, it sustained the FERC on two of the challenges, but vacated both the full avoided cost and interconnection rules.

1. *Full Avoided Cost Rule*

The court set aside the purchase rate rule because "It is apparent that the Commission did not" consider the statutory criteria for such rates "or at least if it did, its rationale and process of consideration were never made explicit." Pet. App. at B-9.[2] The court held that "Congress made a clear distinction between a 'just and reasonable' rate and a rate based on the full avoided cost, though the two *may* coincide." *Id.* at B-10 (emphasis in the original). It examined, in light of this statutory distinction, the reasons offered by the Commission for adopting a rule which, in every case and regardless of circumstances, equates full avoided cost rates with rates that are just and reasonable to consumers. It found that the Commission either failed to consider the hard questions which the "just and reasonable" standard raises, or, if it did consider them, failed to explain how its rule could be reconciled with the explicit requirements of the statute.

The court did *not* hold that a full avoided cost rule would always and necessarily conflict with the statute. Rather, it held "that FERC has not adequately justified

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[2] "Pet. App." refers to the Appendix to the Petition for a Writ of Certiorari in No. 82-34.

its adoption of the full avoided cost standard." *Id.* As the court emphasized in its order denying rehearing, the FERC is free to adopt a full avoided cost rule, if it can "present a cogent justification of its rule in light of the statutory instructions." *Id.* at B-204.

2. *Interconnection Rule*

The court set aside the Commission's blanket exemption of cogenerators from the interconnection provisions of the FPA. It held that since section 210(e)(3)(B) of PURPA expressly prohibits the exemption of qualifying facilities from FPA sections 210 and 212, a rule granting such an exemption violates the statute. Pet. App. at B-22-23. The court found "wholly unconvincing" the FERC's argument that it had implied authority to order interconnections on a blanket basis. It also found "counterintuitive and inconsistent with the statute's explicit provisions" the FERC's contention that the limitation of the exemption authority applied only when cogenerators are targets of, but not applicants for, interconnection orders. Pet. App. at B-24-25.[3]

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[3] The court rejected challenges to two additional aspects of the Commission's rules. First, the court sustained the FERC's "simultaneous purchase and sale" rule, which requires utilities to make net payments to cogenerators for electricity which cogenerators generate and consume for themselves, even though as the court explained, that rule is based upon the "fiction" that this electricity is simultaneously purchased by a utility (at full avoided cost) and sold back to the cogenerator (at the utility's retail rate, typically based on lower embedded costs). Pet. App. at B-17. Second, the court sustained the Commission's refusal to include criteria respecting "fuel use" in its regulation defining "qualifying" cogenerators, thus permitting new oil- or gas-fired cogenerators to qualify for the benefits of PURPA. The court did so even though the principal purpose of the statute was to reduce the use of oil and gas and even though PURPA explicitly authorizes the Commission to include restrictions on fuel use in its definition of "qualifying" cogenerators. PURPA § 201, 16 U.S.C. § 796(18)(B) (Supp. V).

SUMMARY OF ARGUMENT

When Congress enacted PURPA, it recognized (1) that cogeneration, properly implemented, could provide rate savings to consumers and (2) that interconnections between cogenerators and utilities, if not properly implemented, could threaten the reliability of electric transmission systems. Respondent Utilities challenged the Commission's implementing rules because they believe those rules fail to comply with the explicit requirements of the statute, and thereby do violence to the basic objectives of the Act.

A. The Full Avoided Cost Rule

In PURPA, Congress intended to eliminate the barrier to cogeneration resulting from the refusal of some utilities to buy cogenerated power at reasonable rates. It did so by directing the FERC to promulgate rules by which utilities would buy cogenerated power at a fair price, as determined under specified principles, one of which requires these purchase rates to be "just and reasonable to the electric consumers of the electric utility." In adopting this standard, with its well understood consumer protection meaning, Congress contemplated that some of the benefits of cogeneration would be used to provide rate savings to consumers, requiring the Commission to consider carefully alternatives that would accomplish that objective.

Instead, the Commission ignored the statutory mandate, and adopted the full avoided cost rule, which provides no savings to utility ratepayers. It equated the statutory limitation that purchase rates never exceed full avoided cost with rates that are "just and reasonable" to consumers, and thereby adopted the statutory ceiling as the rate floor.

The justifications to support the rule advanced by the Commission in promulgating the rule—and the post-hoc rationalizations advanced by counsel—reflect the assumption that the statute gives the FERC unfettered discretion "to encourage cogeneration" without any limitation other than that purchase rates not exceed full avoided cost. This premise is mistaken; the criteria of section 210(b) require the Commission to consider other countervailing factors, including the interests of ratepayers. Because the FERC's construction is inconsistent with the statute and would frustrate Congressional intent, it must be rejected. *FEC v. Democratic Senatorial Campaign Committee*, 454 U.S. 27, 32 (1981); *Skidmore v. Swift & Co.*, 323 U.S. 134, 140 (1944).

B. The Interconnection Rule

Congress intended that interconnections between cogenerators and utilities would be governed by the interconnection provisions it added to the FPA, and prohibited the FERC from exempting cogenerators from these provisions. Notwithstanding this express limitation on its exemption authority, the FERC exempted cogenerators from the pertinent provisions of the FPA. It did so based upon a misreading of the legislative history, and upon its contention that the statutory limitation on its exemption authority applies only when cogenerators are targets of, but not when they are applicants for, interconnection orders. This construction, however, would deprive unambiguous statutory terms of their plain meaning and render them essentially meaningless. Petitioners' claim that to enforce the interconnection aspects of the statute would have adverse policy consequences is mistaken and, in any event, cannot justify refusal to implement the statute as it was enacted.

ARGUMENT

I. THE FULL AVOIDED COST RULE IS UNLAWFUL

A. The Statute Contemplates that the Purchase Rate Rule Will Afford Rate Savings to Consumers

1. *The Standards of PURPA Section 210(b) Direct the FERC to Consider Distinct, and Potentially Competing, Interests*

The statute removes a barrier which Congress perceived was inhibiting cogeneration by directing the FERC to issue rules, *inter alia*, requiring utilities to purchase cogenerated power. PURPA § 210(a), 16 U.S.C. § 824a-3(a) (Supp. V). The statute thereupon sets forth three ratemaking principles to govern the FERC's purchase rate rule so that rates for these transactions will be fair: the rates (1) are to be "just and reasonable to the electric consumers of the electric utility," (2) "in the public interest" and (3) are not to "discriminate against qualifying cogenerators or qualifying small power producers." PURPA § 210(b). Section 210(b) further specifies that no purchase rate rule "shall provide for a rate which exceeds the incremental cost to the electric utility of alternative electric energy." By both its terms and its structure, the statute requires the Commission to fashion a purchase rate rule which is responsive to the interests of consumers and of the public, each of which is distinct from, and potentially competes with, the interests of cogenerators.

2. *The "Just and Reasonable to Consumers" Standard Has a Traditional, Rate-Related Meaning*

When Congress included the requirement that purchase rates be "just and reasonable to the electric consumers of the electric utility," it knowingly employed an established term of art. The "just and reasonable" standard has a traditional, generally understood meaning developed over many years, in large part in opinions of this Court.

Central to the "just and reasonable" standard are two concepts, one procedural, the other substantive. Procedurally, the standard calls for a balancing of the interests of the affected parties. *See, e.g., Permian Basin Area Rate Cases*, 390 U.S. 747, 770, 792 (1968). Substantively, the overriding purpose of the standard is to protect consumers.[4]

The very language used in section 210(b)—that purchase rates be "just and reasonable *to the electric consumers of the electric utility*"—demonstrates that Congress intended to employ this traditional consumer protection meaning. The Conference Report (H.R. Conf. Rep. No. 95-1750, 95th Cong., 2d Sess. 97, 98 (1978)) confirms this intention by specifying (1) that the Commission interpret the "just and reasonable" standard "in a manner which looks to protecting the interests of the electric consumer in receiving electric energy at equitable rates" and (2) that the standard requires the Commission to set rates at "*the lower of*" full avoided cost and a rate which meets the specific criteria prescribed in section 210(b) (emphasis supplied).

The "just and reasonable" standard requires the FERC to examine closely the effect on utility consumers of purchase rate alternatives, and to balance the interests of consumers with those of cogenerators and the public.[5] *See Permian Basin Area Rate Cases*, 390 U.S. at 770.

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[4] *NAACP v. FPC*, 425 U.S. 662, 666 (1976) (the just and reasonable standard "prevent[s] consumers from being charged any unnecessary . . . costs"); *Atlantic Refining Co. v. Public Service Commission of New York*, 360 U.S. 378, 388-89 (1959) (prices must be set "at the lowest possible reasonable rate consistent with the maintenance of adequate service in the public interest"; the "overriding intent . . . [is] to give full protective coverage to the consumer as to price . . ."); *see also* cases cited in *NAACP*, 425 U.S. at 666 n.3 and 670 n.5.

[5] *See* note 9, *infra*.

By requiring the FERC to undertake this balancing, rather than simply mandating a rate equal to full avoided cost by statute, Congress contemplated that the utility's ratepayers would be afforded some share of the economic benefits of cogeneration, in the form of rate savings. Yet, as the Commission conceded when issuing its regulations, the full avoided cost rule "will not produce any rate savings to the utility's customers." Pet. App. at B-65. This does not necessarily render the rule invalid. However, if the FERC is to sustain a rate which fails to provide rate savings to utility consumers, it must offer a sound explanation of how its rule is nonetheless consistent with the explicit requirement of the statute—a responsibility which, we shall show, *infra*, it has not met.

3. *The Avoided Cost Limitation Is Not a Substitute for the "Just and Reasonable" Standard*

The full avoided cost rule is derived from the statutory ceiling on purchase rates—the limitation that the rule not provide for a rate which exceeds the utility's "incremental cost" of alternative electric energy. The terms and structure of section 210(b) make clear that Congress intended the incremental cost limitation to be distinct from the "just and reasonable" standard and, certainly, that it did not intend to equate the two in all cases. Unlike the three criteria (including the "just and reasonable" standard) which precede the incremental cost limitation, that limitation is not a normative standard at all. It does not obviate the need for any balancing or reconciliation of interests; rather, it fixes an upper boundary for permissible Commission action.

The distinction between the incremental cost limitation and the "just and reasonable" requirement, and the fact that Congress did not intend the former to be a substitute for the latter, is evident in the Conference Report. The Report (at 98, emphasis supplied) specifies that the FERC set rates at *"the lower of"* full avoided cost and a rate which satisfies the rate criteria prescribed

by section 210(b), and further states that the avoided cost limitation "*is meant to act as an upper limit on the price at which utilities can be required under this section to purchase electric energy.*"

The rule converts what Congress imposed as the ceiling on purchase rates—full avoided cost—into the floor. As stated by the court of appeals, "By ordering that the purchase rate be equal to the full avoided cost in every case, FERC has, without convincing explanation, simply adopted as a uniform rule the maximum purchase rate specified in the statute." Pet. App. at B-10.[6]

On its face the full avoided cost rule thus appears to treat the "just and reasonable" standard as surplusage and a nullity. As this Court recently held, in *American Textile Manufacturers Institute v. Donovan*, 452 U.S. 490, 513 (1981):

> Adoption of petitioners' interpretation would effectively write § 6(b)(5) [of OSHA] out of the Act. We decline to render Congress' decision to include a feasibility requirement nugatory, thereby offending the well-settled rule that all parts of a statute, if possible, are to be given effect.

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[6] While the FERC adheres to the statutory ceiling of full avoided cost in its own rules, it invites the States to go above that ceiling:

> While the rules prescribed under section 210 of PURPA are subject to the statutory parameters, the States are free, under their own authority, to enact laws of [sic] regulations providing for rates which would result in even greater encouragement of these technologies.

Pet. App. at B-62. This suggestion is of dubious constitutional validity in that there is federal preemption over wholesale electric rates and PURPA § 210(f), 16 U.S.C. § 824a-3(f) (Supp. V), requires the state commissions to implement the cogeneration rules, which PURPA § 210(b) specifies may not provide for a rate exceeding full avoided cost. *See, e.g., Fidelity Federal Savings & Loan Ass'n. v. de la Cuesta*, 102 S.Ct. 3014, 3022 (1982); *Townsend v. Swank*, 404 U.S. 282, 286 (1971).

Since the Commission has rendered the "just and reasonable" standard "redundant or largely superfluous, in violation of the elementary canon of construction that a statute should be interpreted so as not to render one part inoperative," *Colautti v. Franklin*, 439 U.S. 379, 392 (1979), its invalidation must be sustained. As noted *supra*, the Commission can only adopt a rule which sets all rates under the rule at the statutory ceiling if it considers and cogently explains how such a rule gives meaning to the "just and reasonable" standard. As we now show, no such explanation has been offered.

B. The FERC's Justifications for the Rule Fail to Explain How It Can Be Squared with the Statute

1. *The Specific Justifications Offered by the Commission Are Inadequate*

The Commission, when adopting its regulation, provided scarcely any justification for the full avoided cost rule. What "reasons" it did advance were confined to a few sentences (*see* Pet. App. at B-65-66) which, as the court of appeals found, fail to offer any reasoned explanation of how the rule takes meaningful account of the criteria specified in section 210(b).[7]

The legal deficiencies of the FERC's rationale go beyond the manifest inadequacies of its specific justifications for the rule. In its order promulgating the rule, and subsequent order denying rehearing, the FERC never specifically addressed the application of the "just and reasonable" standard.[8] It never explained how it was

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[7] As we show at pages 19-20, *infra*, petitioners' attempts, first raised in appellate advocacy, to claim that the Commission has satisfied the "just and reasonable" standard are without merit.

[8] Prior to its appellate briefs, the FERC's only mention of the application of the "just and reasonable" standard to the purchase rate rule is contained in a Commission Staff Paper, which recognizes the statutory interest in a rate below full avoided cost:

interpreting the standard or what meaning it was assigning to it, and never explained how a rule which concededly provides no savings to utility consumers comports with that standard.[9]

The "just and reasonable" standard contemplates that the Commission would, at the least, consider carefully alternative rules which would capture some rate savings for consumers. The Commission considered only one alternative to the full avoided cost rule—namely, the "split-the-savings" approach of dividing the benefits of the transaction between buyer and seller on the basis of their respective costs. The Commission rejected this approach, which is common in the electric utility industry, because it believed that it would impose upon qualifying facilities the type of intrusive regulation which Congress directed it to avoid. Pet. App. at B-64-66.

> So long as the price is less than the alternative cost to the utility, the buying utility's ratepayers benefit from such transactions, and the statute would seem to be satisfied.

Joint Appendix at 30.

[9] The Commission's failure to explain its interpretation of the "just and reasonable" standard is particularly troublesome because of its failure to make any effort to take cogenerator production costs into account in promulgating rates under section 210(b). The fact that Congress did not intend to subject cogenerators to intrusive utility-type regulation did not authorize the Commission to ignore entirely cogenerators' costs in balancing their interests with those of ratepayers. As this Court has frequently recognized, production costs are a critical factor in determining "just and reasonable" rates. *See, e.g., Permian Basin Area Rate Cases*, 390 U.S. at 769 and 791-92 (the Commission is to consider the "financial . . . requirements" of the parties seeking to charge "just and reasonable" rates); *Acker v. United States*, 298 U.S. 426, 428 (1936) (the "prime factor is the . . . cost . . ." of providing the service for which the rate is being charged). *Cf. Mobil Oil Corp. v. FPC*, 417 U.S. 283, 301 (1974).

In this regard, the Conference Report explained that while Congress wanted to avoid establishing "utility type regulation" over cogenerators, it did not contemplate that they be exempt from in-

By its terms, however, the Commission's concern applies only to approaches which require case-by-case examination of the costs incurred by individual cogenerators. It has no bearing on the numerous methods of computing purchase rates that do not require such individualized proceedings.[10] The Commission never examined any of these other options, offering instead two conclusory and inadequate "justifications" for its rule.

a. *The Commission's Assertion of "Insignificant" Savings Is Inadequate*

The Commission's first "justification" referred to the rule's effects on utility ratepayers. The full text of that justification (at Pet. App. at B-65) was:

> The Commission notes that, in most instances, if part of the savings from cogeneration and small power production were allocated among the utilities' ratepayers, any rate reductions will be insignificant for any individual customer. On the other hand, if these savings are allocated to the relatively small class of qualifying cogenerators and small power

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quiry pertinent to the purchase rates they are to be paid. The Report specified that (Conf. Rept. at 98; emphasis supplied):

> the examination of the level of rates which should apply to the purchase by the utility of the cogenerator's or small power producer's power should not be burdened by the same examination as are utility rate applications, *but rather in a less burdensome manner.*

However, the Commission has, without cogent explanation, refused to take cogenerator costs into account at all, even though it may well have been able to do so in ways that would be far "less burdensome" than requiring the kind of complex, in-depth study of individual costs undertaken in a utility proceeding (for example, on a generic technology-by-technology basis).

[10] These methods include setting the rate across-the-board at a fixed percentage of avoided cost (such as 80% or 90%), setting rates on a technology-by-technology basis, either at a particular level (not to exceed full avoided cost) or at a fixed percentage of avoided cost, and giving the state commissions a permissible range of percentages of avoided cost which they could apply generically or on some other reasonable basis pursuant to FERC guidelines.

> producers, they may provide a significant incentive for a higher growth rate of these technologies.

This bald claim of "insignificant" savings for "any individual customer" was the Commission's only reference to the rule's impact on the "electric consumers of the electric utility."[11] As the court of appeals explained, it gives no meaning to the "just and reasonable" standard since "*as Congress surely knew . . .* inevitably the impact of FERC's rules per consumer will be less than their impact per cogenerator." Pet. App. at B-11 (emphasis supplied). It simply does not suffice to satisfy the FERC's duty to adopt a rule that is "just and reasonable" to electric consumers.

The Commission never attempted to evaluate the potential savings from specific alternatives to its 100% rule. It did no more than glibly assert that "*in most instances*" rate savings would be "insignificant for any individual customer." Pet. App. at B-65 (emphasis supplied). It did not explain the basis for its refusal to set rates below avoided cost in those *other* instances in which it implicitly concedes savings from such rates might be significant. Further, and most critically, it never explained its reasons for ignoring the potential savings for consumers as a group (or for individual classes of consumers) even though this Court has explicitly held that the Commission has a duty to consider aggregate rate impacts on consumers in establishing just and reasonable rates.[12]

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[11] The Commission never specified what level of savings it deemed "insignificant."

[12] *See FPC v. Texaco Inc.*, 417 U.S. 380, 399 (1974) (holding that the Commission cannot ignore its duty to adopt just and reasonable rates because they "would make a small dent in the consumer's pocket"). As one of the respondents said when asking the FERC to reconsider the rule, the Commission could "[a]s well say that utilities should be permitted to overcharge everyone a little, on the grounds that no one will feel it." Application for Rehearing of American Electric Power Service Corporation. Record at 3552.

The briefs to this Court demonstrate that the claim of "insignificance" is far off the mark.[13] For example, the Natural Resources Defense Council Inc., *et al.* (NRDC), in their brief as *amici curiae*, cite the draft environmental impact statement for the FERC's rulemaking, and Department of Energy and other published studies, to demonstrate the massive potential for cogeneration and small power production—totaling some 25 percent of the nation's current demand for electricity and as much as 40 percent of demand within a few decades. NRDC Br. at 11-12. The expectation of such significant amounts of cogeneration belies the claim that a rule providing for some sharing will produce "insignificant" benefits to consumers, since even a small reduction in purchase rates could lead to substantial savings for consumers if the amount of electricity being sold is large.[14]

b. *The Commission's Claim That Only a Full Avoided Cost Rule Will Encourage All Possible Cogeneration Is Inadequate*

The Commission's second "justification" discussed the effects of alternatives to the full avoided cost rule (Pet. App. at B-66):

> If some fixed percentage is used, a qualifying facility may cease to produce additional units of energy

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[13] As the court of appeals held, "Since the Commission is required by statute to consider the impact of its rate setting on 'electric consumers of the electric utility' it is especially necessary for FERC to demonstrate the factual basis for its conclusion of 'insignificant' savings for them." Pet. App. at B-11.

[14] Thus, a rule that purchase rates equal 80 percent of avoided cost would provide consumer savings of 5 percent where cogeneration accounts for 25 percent of the nation's supply of electricity. The approximate value of this saving—$3.6 billion—was cited by Senator Hart, prior to the enactment of PURPA, as the likely level of rate benefits to be realized by household consumers each year from cogeneration. 123 Cong. Rec. 32419 (1977).

> when its costs exceed the price to be paid by the utility. If this occurs, the utility will be forced to operate generating units which either are less efficient than those which would have been used by the qualifying facility, or which consume fossil fuel rather than the alternative fuel which would have been consumed by the qualifying facility had the price been set at full avoided costs.

The Commission's point, as recognized by the court below, is that since a rule which permits rates below full avoided cost "might be insufficient to encourage the last kilowatt hour of cogeneration," that "justifies shutting the utility's customers out of any share of the benefits." [15] Pet. App. at B-12. This explanation constitutes a direct rejection of the duty to apply the "just and reasonable" standard.

The Commission relies on the assumption that, all other things being equal, the payment of full avoided cost *may* encourage more cogeneration than would payment at a lesser rate.[16] By so doing the Commission deprives section 210(b) of any meaning. If Congress believed that the possibility that a 100% rule *might* encourage additional cogeneration was sufficient to justify such a rate, it could have prescribed a 100% rate by statute. But, by enacting section 210(b), Congress was not determined (as is the Commission) to bring forth "the last kilowatt hour of cogeneration," regardless of the effects thereof on rate-

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[15] By its terms the Commission's point applies only where a fixed percentage rate is used. It does not apply to a rule that would permit the States to set rates at full avoided costs for those cogenerators that require payment at that level, but at lower rates for other facilities.

[16] In fact, the Commission never concluded that a rate below 100% of avoided cost (e.g., 90%) would fail to encourage as much cogeneration as the higher rate, simply noting that *if* such a rate were insufficient for some cogenerators, a 100% rate *might* suffice.

payers. Instead, it sought to "encourage cogeneration" *by removing the obstacles* that impeded its development (*i.e.*, the claimed unwillingness of utilities to buy cogenerated power at a fair price), in a way that recognized the interest in capturing potential rate savings for electric consumers, through rates at "the lower of" full avoided cost and rates which satisfied the criteria specified in section 210(b).[17] By contrast, the Commission's interpretation eliminates any purpose for the inclusion of these criteria in the Act.[18]

Notably, the Commission did not even purport to consider the extent to which alternatives to the full avoided cost rule would induce cogeneration, or to estimate the rate savings that alternatives could provide to consumers. Nor did it consider the extent to which a full avoided cost rule might provide many qualifying facilities with windfall profits at the expense of electric ratepayers.[19] In short, the FERC's justification is nothing more than what the court of appeals described as a "bare, unquantified possibility" (Pet. App. B-12) and as such cannot stand.

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[17] While section 210(b) specifies that rates be "just and reasonable" to consumers, its only direct reference to the interests of cogenerators is that purchase rates not discriminate against them.

[18] The Commission's approach here is much like OHSA's—that exposure to 1 ppm of benzene is necessarily safer than exposure to higher levels and that this assumption justifies failing to apply countervailing statutory factors—which this Court found wanting in *Industrial Union Department, AFL-CIO v. American Petroleum Institute*, 448 U.S. 607, 634, 639-40 (1980).

[19] The Commission permits payment at rates below full avoided cost to cogenerators which antedated PURPA. 18 C.F.R. § 292.304 (b)(3). In so doing, the Commission recognized that rates at full avoided cost may be too high, providing windfall gains to some cogenerators at the expense of utility consumers. This same potential exists in the case of new facilities, yet the Commission took no account of it in promulgating the rule.

2. *The Commission's Justifications for the Rule, First Offered in Appellate Briefs, Are Mistaken*

a. *The Petitioners Misapply the Concept of the "Zone of Reasonableness"*

In its brief, the FERC offers a justification which was not advanced when the rule was adopted, arguing that, since "Congress clearly contemplated that a full avoided cost rate would be within [a zone of reasonableness], albeit at the upper end," this Court may not set aside the rule. (FERC Br. at 18-19, citing *Permian Basin Area Rate Cases*, 390 U.S. at 767).

The argument is premised on an erroneous assumption: Congress did not determine what the "zone of reasonableness" is, and did not equate the full avoided cost limitation with rates that are within that zone.[20] Rather, it established in section 210(b) the criteria for the Commission to employ—the factors to be balanced—in deciding where the zone of reasonableness for purchase rates will lie. Until the Commission engages in the balancing of interests which the statute requires, it cannot determine whether a full avoided cost rule sets rates within that zone.

b. *The FERC Errs in Arguing that the "Just and Reasonable" and "Public Interest" Standards Are Interchangeable*

The FERC argues, again as a new justification, that "[t]he terms 'in the public interest' and 'just and reasonable' are interchangeable." For this the Commission cites *United Gas Pipe Line Co. v. Mobile Gas Service*

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[20] Instead, it selected a statutory structure that expressly contemplates that while a full avoided cost rate *may* be within the zone, it also may exceed what is "just and reasonable" to utility consumers and therefore be outside the zone. Where the latter is the case, the lower of the two rates is to apply. *See* Conf. Rep. at 98 (quoted *supra* at 10-11).

Corp., 350 U.S. 332, 345 (1956), and *FPC v. Sierra Pacific Power Co.*, 350 U.S. 348, 355 (1956). The suggestion seems to be that a purchase rate rule that meets the FERC's view of the "public interest" (which is to encourage cogeneration to the maximum feasible extent) necessarily satisfies the "just and reasonable" standard, regardless of the effect of the rule on the rates of utility consumers. (FERC Br. at 18 n.20).[21] Such a suggestion would deprive the "just and reasonable" standard of independent content, notwithstanding its specific and separate delineation in section 210(b).

Contrary to the contention, the cited decisions do *not* use the terms interchangeably. Rather, they hold that "public interest" factors will be considered within the scope of the terms "just and reasonable" in statutory provisions which, unlike section 210(b), do not contain any independent "public interest" standard. They do not question that the term "just and reasonable" in a federal power rate statute carries the definite, well understood rate-related meaning that it carried before, and has continued to carry since those cases were decided.[22]

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[21] The Commission's point, first raised in its brief to this Court, is a post-hoc rationalization of appellate counsel which cannot substitute for the Commission's interpretation of the statute at the time it promulgated the rule. *See Investment Company Institute v. Camp*, 401 U.S. 617, 627-28 (1971).

[22] *See* pages 8-10, *supra*. The focus of "just and reasonable" is precisely on what the FERC calls "the narrow questions" of "lower rates to consumers." (FERC Br. at 19 n.20) By specifying in § 210(b) that purchase rates be "just and reasonable *to the electric consumers of the electric utility*" (emphasis supplied), Congress made clear its intention to use the standard consistent with its traditional meaning and not to permit the Commission (and certainly not its appellate counsel) to dismiss the possibility of rate savings to consumers as a matter of little moment.

C. Under the Governing Standards of Judicial Review, the Avoided Cost Rule Should Be Vacated and Remanded to the Commission

1. *The Commission Has Failed to Demonstrate Any Basis for Deferring to Its Construction of Section 210(b) of PURPA*

An agency's construction of a statute is entitled to deference, and is not to be overturned if it is " 'sufficiently reasonable' to be accepted by a reviewing court." *FEC v. Democratic Senatorial Campaign Committee*, 454 U.S. 27, 39 (1981). However, as Justice Jackson expressed the matter in *Skidmore v. Swift & Co.*, 323 U.S. 134, 140 (1944):

> The weight of [agency] judgment in a particular case will depend upon the thoroughness evident in its consideration, the validity of its reasoning, its consistency with earlier and later pronouncements, and all those factors which give it power to persuade, if lacking power to control.

Further, as this Court stated in *Democratic Senatorial Campaign Committee*, 454 U.S. at 32 (emphasis supplied):

> [T]he courts are the final authorities on issues of statutory construction. They *must reject* administrative constructions of the statute, whether reached by adjudication or by rulemaking, that are inconsistent with the statutory mandate or that frustrate the policy Congress sought to implement.

The Commission has failed to demonstrate any convincing basis which justifies deference to its interpretation of section 210(b). Even though its purchase rate rule departs sharply from the traditional meaning of the "just and reasonable" standard, and fails to capture any share of the cost savings for ratepayers, the Commission never attempted to offer a coherent justification for the rule in light of the statutory standard.[23] In its brief to this

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[23] *See, e.g., Investment Company Institute v. Camp*, 401 U.S. 617 (1971).

Court, the FERC still fails to offer any explanation that withstands scrutiny when measured against the requirements of the statute.[24]

The premise of each of the Commission's justifications for the rule is that section 210 gives it unfettered discretion to ignore express statutory requirements if it believes that doing so would "encourage cogeneration." The FERC thereby reads the "just and reasonable to the electric consumers" standard as imposing no duty upon it other than to ascertain that its rule not exceed the full avoided cost ceiling. However, when Congress enacted section 210(b)'s rate criteria, it made evident that the statute is not a "blank check" to encourage cogeneration, regardless of other interests. Instead, it required the Commission to give meaning to the "just and reasonable" criterion, by considering "the hard questions which the standard necessarily raises" (Pet. App. at B-10), and to take account of the interests of consumers in rate savings when engaging in the balancing of countervailing interests the statute demands.[25]

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[24] *See International Brotherhood of Teamsters v. Daniel*, 439 U.S. 551, 565-66 (1979). The FERC's contention that Judge Wilkey's opinion for the court of appeals represents a "marked departure" from "traditional standards" of judicial review seriously mischaracterizes the decision below, which recognized the court's obligation to give deference to the FERC's construction of the statute, but found that the FERC had failed to offer any convincing explanation of how its rule could be squared with the statutory requirements. Pet. App. at B-9, 18.

[25] Diamond Shamrock Corporation *et al.* (Diamond Shamrock) share the FERC's conclusion that the "just and reasonable" standard has no meaning independent of the full avoided cost limitation, but reach this conclusion more directly. These companies say expressly that § 210(b) requires only that purchase rates cause no harm to utility consumers, *i.e.*, that the standard requires no more than that "utilities pay not a penny more" than the full avoided cost. Br. at 24. They dismiss the notion that the statute imposes upon the Commission the duty to balance the interests of cogenerators, ratepayers and the public as "pure invention" (*id.* at 21) and

The FERC argues nonetheless that deference to its construction of section 210(b) is "particularly appropriate" since its interpretation represents "a contemporaneous construction of a statute by the men charged with setting its machinery in motion . . ." (FERC Br. at 20-21 quoting *Udall v. Tallman*, 380 U.S. 1, 16 (1965)). But the "contemporaneous construction" principle does not shield an interpretation from review, serving as "only one input in the interpretation equation." *Zuber v. Allen*, 396 U.S. 168, 192 (1969) (Harlan, J.). A contemporaneous construction is only to be sustained if it is consistent with the mandate of the statute and with Congressional intent.[26]

The basis for deferring to the FERC's construction in this case is particularly weak. Nothing in the legislative history suggests that Congress had any reason to suspect that the FERC would interpret section 210(b) in the present manner, and the effect of the FERC's interpretation is to eliminate any purpose for including section 210(b)'s rate criteria in the Act. Consequently, the FERC's construction of the statute may not be sustained.

2. *In Promulgating the Rule, the Commission Not Only Misinterpreted the Statute, But Also Failed To Engage in Reasoned Decisionmaking And Acted in an Arbitrary and Capricious Manner*

The Commission focuses much of its argument on its claim that the court of appeals misunderstood the appropriate standard of review and applied the substantial evidence test. This mistaken assertion is drawn from the court's footnote citation of *Public Systems v. FERC*, 606 F.2d 973 (D.C. Cir. 1979).[27] However, the court of ap-

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admit in this regard, that "the Commission did not follow this far-ranging and highly unstructured procedure" (*id.* at 23).

[26] *National Muffler Dealers Ass'n v. United States*, 440 U.S. 472, 477 (1979); *Zuber v. Allen*, 396 U.S. at 192-93.

[27] Likewise, the statement to this effect by Judge Wald and Judge Mikva, in dissenting from the decision denying rehearing *en banc*, Pet. App. at B-207 n.2, merely refers to this footnote without explanation.

peals never purported to employ the substantial evidence test in its decision and cited *Public Systems* only to support the proposition that the FERC has an obligation to engage in reasoned decisionmaking (Pet. App. at B-12)[28] —an obligation which applies with equal force regardless of the standard of review.

In fact, although the court of appeals did *not* misapply the standard, the FERC's characterization of the decision of the court below is irrelevant since application of the proper standard of review requires that the rule be reversed. The FERC's principal failing is that it did not offer an adequate explanation of how the rule satisfied the statute's express requirements. Informal rulemaking never was intended to give administrative agencies license to ignore statutory requirements. Whatever the applicable standard of review—whether under the substantial evidence test, or 5 U.S.C. § 706(2)(A), directing reversal of agency action that is "arbitrary and capricious" or "not in accordance with law"—agency decisions must be consistent with statutory mandates. Since the FERC failed properly to construe the statutory requirement that its rule be "just and reasonable to the electric consumers," it cannot be upheld.

Further, even if the only issue on review were whether the Commission's decision was arbitrary and capricious, the rule could not be sustained. The essence of an agency's obligation under the arbitrary and capricious test is to consider all of the relevant factors—that is, to engage in a "rational weighing of competing policies." *FCC v. National Citizens Committee for Broadcasting*, 436 U.S. 775, 803 (1978); *see also FCC v. WNCN Listeners Guild*, 450 U.S. 582, 594 (1981) (each case applying

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[28] Although *Public Systems* did apply the substantial evidence test (because the rule was an order pertaining to rates under the Federal Power Act), the opinion noted that the requirement of reasoned decisionmaking applies with equal force where the standard of review is "arbitrary and capricious." *See* 606 F.2d at 980 n.34.

an arbitrary and capricious standard of review).[29] The FERC's duty not to produce an "arbitrary result," *Permian Basin Area Rate Cases*, 390 U.S. at 790, compels it to give "reasoned consideration to each of the pertinent factors," *id.* at 792 (which that opinion describes as "the various interests which Congress has required it to reconcile," *id.* at 770).

The purpose of including the section 210(b) rate criteria in PURPA, rather than mandating a full avoided cost rule by statute, was to attempt to capture potential rate savings for consumers, if that could be done in a manner which is in the public interest and does not discriminate against cogenerators. In order to determine if this could be accomplished, the Commission was required to examine carefully the possibility of adopting a purchase rate rule that set rates *below* the statutory maximum of full avoided cost. As we have shown, the Commission failed to do this; it failed to make any effort to consider seriously alternatives to full avoided cost, or to consider the effects upon consumer rates and upon cogenerators that alternative rules might provide. It thereby failed to discharge its duty to base its rule "on consideration of the relevant factors." *FCC v. National*

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[29] As this Court held in *SEC v. Chenery Corp.*, 332 U.S. 194, 196-97 (1947), review under the arbitrary and capricious standard requires an agency to offer a reasoned explanation in order to provide the court with a basis for review:

> If the administrative action is to be tested by the basis upon which it purports to rest, that basis must be set forth with such clarity as to be understandable. It will not do for a court to be compelled to guess at the theory underlying the agency's action; nor can a court be expected to chisel that which must be precise from what the agency has left vague and indecisive. In other words, "We must know what a decision means before the duty becomes ours to say whether it is right or wrong." (citation omitted).

Citizens Committee for Broadcasting, 436 U.S. at 803.[30] As such its action was arbitrary and capricious.

3. *Remanding the Full Avoided Cost Rule Will Neither Impose Unreasonable Burdens Upon the Commission Nor Require that It Undertake Adjudicatory Hearings*

The Commission erroneously argues that remand is inappropriate since the court of appeals violated the constraints on judicial interference with agency procedures which this Court articulated in *Vermont Yankee Nuclear Power Corp. v. Natural Resources Defense Council, Inc.*, 435 U.S. 519 (1978). FERC Br. at 31-32. The Commission offers two arguments in this regard.

First, it suggests that the court of appeals decision requires the Commission to undertake full adjudicatory hearings. However—unlike the appellate court's original decision in *Vermont Yankee*—the decision below leaves the procedures to be followed on remand entirely to the Commission, without any basis for inferring that extraordinary procedures are contemplated or required.[31]

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[30] Petitioner American Paper Institute, Inc. (API) would excuse the Commission's "justifications" because, it argues, the Administrative Procedure Act (APA) requires only a "concise general statement of the basis and purpose" of a rule. 5 U.S.C. § 553(c). API Br. at 13. But, the APA does not excuse the FERC from explaining how its action satisfies statutory requirements and from providing a basis for its principal findings. *Chenery*, 332 U.S. at 196-97; *Citizens to Preserve Overton Park, Inc. v. Volpe*, 401 U.S. 402, 416 (1971). *See also Permian Basin Area Rate Cases*, 390 U.S. at 814; *National Nutritional Foods Ass'n v. Weinberger*, 512 F.2d 688, 701 (2d Cir.), *cert. denied*, 423 U.S. 827 (1975) ("a thorough and comprehensible statement of the reasons" for an agency decision is especially advisable where there has not been an evidentiary hearing).

[31] The FERC's contention that to sustain its rule under the decision below would require it to undertake an exhaustive analysis of the costs of "every sort of cogeneration and small power production

The Commission's second argument is that remand is inappropriate because *the court* "did not indicate how the Commission could better support in a rulemaking record any particular percentage of avoided cost other than 100%." This contention misconstrues the appropriate relationship between administrative agencies and the courts. The court's task is to review the legality of the agency's action, not to specify how the agency should conduct the remanded proceeding. Once the court of appeals decided, correctly, that the FERC failed to apply the statutory criteria properly, the responsibility passed to the agency to determine (subject to any further judicial review) what sort of factual inquiry the statute commands.

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technology" (FERC Br. at 30-31 n.33) suffers from three fatal flaws.

First, the Commission has not yet made any determination that examination of the generic costs of various cogeneration technologies is infeasible or would unduly restrict the success of the program. Counsel's post-hoc rationalizations cannot substitute for a finding the FERC never has made. See note 21, *supra*.

Second, there is good cause to believe that the FERC could undertake an analysis of costs on a generic technology-by-technology basis without undue burden. Published reports indicate that relatively few industries (e.g., paper, steel, chemicals) account for a substantial percentage of the cogeneration potential, and there is data available concerning the costs of cogeneration for some or all of these industries. *See, e.g.*, Resource Planning Associates, *The Potential for Cogeneration Development in Six Major Industries by 1985* (1977).

Third, even if the Commission determines that it is infeasible to consider costs, there are alternatives to full avoided cost which would provide rate savings to consumers (e.g., a rule setting rates at a specified percentage of avoided cost). Estimates of the amount of potential cogeneration (*see, e.g.*, API Br. at 19-20; NRDC Br. at 11-12), provide a useful basis for estimating the potential savings to ratepayers under such rates.

The FERC's claim that the rule should be sustained under two of this Court's "predictive judgment" cases, FERC Br. at 31, is likewise based on a misunderstanding of its statutory responsibility. These cases hold that "complete factual support in the record is not . . . possible or required" in rulemaking proceedings which require a predictive judgment based upon agency expertise.[32] In each case, the agency had properly interpreted the governing statutory criteria and made a good faith effort to apply those criteria on the basis of available facts. Because the issues to be evaluated required forecasts of future conduct and were not readily susceptible to quantitative analysis (*e.g.*, in *WNCN*, the effect of a possible change in the FCC's rule on diversity in programming), the agencies were allowed to rely upon "expert judgment" in applying the available facts to the predictive judgments they were called upon to make. However, those cases do not excuse an agency which, like the FERC here, has failed to attempt to apply available data to the statutory criteria or to explain how its action comported with those criteria.

D. The Decision of the Court of Appeals was Narrow and Confined, and Did Not Substitute the Court's Judgment for that of the FERC

1. *The Court of Appeals Left the Responsibility to Balance Competing Interests to the FERC*

The Commission repeatedly attempts to characterize the decision below as precluding it, as a matter of law, from adopting a rate equal to full avoided costs.[33] Based upon this contention, the Commission accuses the court of

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[32] *FCC v. WNCN Listeners Guild*, 450 U.S. at 594-95; *FPC v. Transcontinental Gas Pipeline Co.*, 365 U.S. 1, 28-29 (1961).

[33] *See, e.g.*, FERC Br. at 17-18. The FERC would have this Court "pierce the literal language" of the court's decision in order to determine that the court of appeals did not really mean what it said.

appeals of improperly "substitut[ing] its view of public policy for that of the Commission."[34] Yet, in its original opinion, and again on rehearing, the court of appeals expressly confined its holding to the Commission's failure to justify its decision, and emphasized that the Commission could have adopted a full avoided cost rule, if it were based upon appropriate analysis and findings.[35]

The Commission also objects with misplaced vehemence to the following statement of the court of appeals (found at Pet. App. B-12):

> [the Commission] should allocate the benefits more evenly between the cogenerators and the utilities if the utilities can demonstrate that, under a percentage of avoided cost approach, an allocation less heavily favoring the cogenerators is in the public interest and the interest of the utilities' electric consumers, and will not disproportionately discourage cogeneration.

The statement only confirms that the court of appeals recognized that the judgments to be exercised in the statutory balancing of interests were for the Commission, and not for the court. The court's paraphrase of the statutory test directs the Commission to evaluate consumer interests, other public interest considerations and effects on cogenerators, and to make a good faith effort to strike an appropriate balance among these potentially competing interests. As the court made clear, it is for the Commission to make the judgmental determinations necessary to apply the statutory criteria. The statute demands no less.

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[34] FERC Br. at 16, also at 17 & n.17, 21, 32. Far from substituting its judgment for that of the Commission, the court of appeals upheld two of the four Commission rules challenged before it, giving "a great deal of deference" to the FERC's construction of statutory terms. (Pet. App. at B-19).

[35] *See* Pet. App. at B-9, 10, 16, 203-04. *See* pages 4-5, *supra*.

2. *The Court of Appeals Did Not Misunderstand the Basis or the Effects of the Rule*

The Commission and its supporters devote large portions of their briefs to an attempt to show that the court of appeals misunderstood the basis and effects of the full avoided cost rule, in order to support their claims that the court substituted its judgment for that of the Commission.[36] At most, these arguments are tangential since the question before this Court is whether the FERC acted lawfully in promulgating the rule. However, these arguments, even though not germane, are mistaken; the court below did not misunderstand either the rule or its effects.[37]

State Commission Application for Waivers of the Rule

The Commission claims that the court below failed to take account of the provision of the regulations that permits state commissions to apply to the FERC for a waiver of the full avoided cost rule. FERC Br. at 22. But this waiver provision is quite limited. It is available

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[36] These arguments are advanced not as positive reasons for sustaining the rule, but rather only to show that the court of appeals allegedly substituted its judgment for that of the Commission. Had they been offered as rationales for the rule, they could not sustain it since the Commission did not mention them in justifying the rule. As such, they are merely post-hoc rationalizations of counsel which are not a substitute for action of the agency itself. *See, e.g., Investment Company Institute v. Camp*, 401 U.S. 617, 627-28 (1971); *Citizens to Preserve Overton Park, Inc. v. Volpe*, 401 U.S. 402, 419 (1971).

[37] NRDC *et al.*, reflect their misunderstanding of the rule when they cite the provision of the rule not requiring full avoided cost rates for facilities that antedated PURPA for their mistaken view that the avoided cost rule applying to all "new" cogenerators is "more a guideline than a specific rate" by which state commissions are given broad power to set rates below full avoided cost. NRDC Br. at 7 & n.8. The FERC's treatment of these "pre-existing" cogenerators has no bearing upon the legality of the purchase rate rule for new facilities.

only to state commissions, and not to utilities or ratepayers,[38] and the state commissions may apply only after issuing a public notice in the utility's service area. The provision does not dispense with the presumption in favor of the rule, but rather provides that a waiver will be granted only if the state commission demonstrates that, in the circumstances, a full avoided cost rate "is not necessary to encourage cogeneration and small power production and is not otherwise required under section 210 of PURPA," 18 C.F.R. § 292.403. State commissions are not likely to undertake the burden of seeking such a waiver frequently[39] (and API points out that no application for waiver of the full avoided cost rule has heretofore been sought).[40]

The Parties' Ability to Negotiate Rates Below Full Avoided Cost

The Commission observes that under its rules, "qualifying facilities *may* negotiate contract prices that are

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[38] This distinguishes the FERC's limited waiver from the procedures referred to in the "safety valve" cases cited by API. Those procedures (which the Court characterized in the *Permian Basin Area Rate Cases*, 390 U.S. at 772 as "broad guarantees of special relief") all permitted the affected party itself to apply for the exception. API cites those cases only to say that such procedures can enhance the validity of an agency's exercise of "*discretion* to proceed in complex areas" API Br. at 25 n.19 (emphasis supplied). But, an agency has no discretion to fail to adhere to statutory commands and cannot excuse such failure because it might, on occasion and after application, choose to abide by its statutory responsibilities in a specific case.

[39] Since PURPA requires the state commissions to follow the FERC's rules, the FERC's determination that full avoided cost rates are required carries a presumptive validity likely to discourage state commissions from evaluating the possibility of rates below full avoided cost for themselves, or from attempting to seek waivers, which they may conclude are unlikely to be granted. This is particularly so since the Commission has invited state commissions to *exceed* the incremental cost ceiling. *See supra* note 6.

[40] API Br. at 23-24, n.16 and 25, n.19.

lower than full avoided cost rate." FERC Br. at 22 (emphasis supplied). However, the question is whether rates *under the rule* are "just and reasonable" to utility ratepayers. That cogenerators may agree voluntarily to forego their rights to be paid full avoided cost is of limited practical benefit, since they can demand payments at that level.[41] In any event, the possibility that a cogenerator may waive a right is no defense to the legality of a rule specifying that right.[42]

The Claim that Ratepayers Will Obtain Long-Range Benefits from a Full Avoided Cost Rule

While some of the briefs suggest that consumers will obtain long-term rate benefits from the full avoided cost rule,[43] the Commission found expressly to the contrary, stating in its Order that "use of the full avoided cost standard will not produce any rate savings to the utility's customers." Pet. App. at B-65 (quoted by the FERC at page 7 of its brief). This finding is compelled, since the rule requires the utility to pay 100% of its avoided costs—stated otherwise, to pay all of the benefits of the transaction—to cogenerators. Even if the availability of cogenerated power permits the utility to avoid or defer construction of new plants or to reduce reliance on expensive peak load facilities, under the FERC's rule, consumers' rates will not be reduced, since the utility will

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[41] The rule specifies that a cogenerator need not negotiate rates below full avoided cost to obtain a long-term rate commitment from the utility, by giving the cogenerator the right to full avoided cost payments not only currently but "over a specified term" once it unilaterally commits to a "legally enforceable obligation" to provide the utility with energy or capacity. *See* 18 C.F.R. § 292.304 (d)(2); Order No. 69, Pet. App. at B-71-73.

[42] API's claims that utilities will take unfair advantage of cogenerators is unwarranted; and, in any event, both the rule and the oversight of utilities conducted by the FERC and the state commissions protect cogenerators should any abuse occur.

[43] *See*, Brief for Kerr-McGee Chemical Corporation *et al.* (Kerr-McGee) at 16-21; NRDC Br. at 17-21.

be required to pay to cogenerators the full measure of the avoided costs.

Futhermore, any claim that ratepayers would enjoy long-term non-rate benefits would not respond to the Commission's duty to consider, under the "just and reasonable" standard, the rate impact of its rule.[44] It is likely that, absent the FERC's rule, many cogenerators would have sold power to utilities at less than full avoided cost. Indeed, the Commission's treatment of pre-PURPA cogenerators demonstrates the Commission's recognition that cogenerators do not necessarily require payment of full avoided cost in order to operate.[45] 18 C.F.R. § 292.304 (b)(3). By requiring the payment of full avoided cost to every new cogeneration facility (including the many that would have been installed at purchase rates set at less than full avoided cost), the FERC's rule deprives utility consumers of benefits they would have reaped but for PURPA.[46]

The Court of Appeals' Discussion of Market Forces

The Commission devotes several pages of its brief to the court of appeals' discussion of market forces, includ-

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[44] Reference to the benefits of oil and gas savings, for example, is ironic since the Commission did not consider alternative purchase rate rules that would have avoided unduly encouraging oil- and gas-fired cogeneration where such cogeneration would increase overall use of such fuels.

[45] The FERC's claim that a full avoided cost rate "duplicates the context" of a free market is mistaken. In a competitive market, the price will be in equilibrium between *both* the utilities' and the cogenerators' marginal costs. In such a market, it is doubtful that any party would agree to an arrangement which conferred all of the benefits of the transaction upon the other party.

[46] The rule's adverse effects on utility consumers are exacerbated by the "simultaneous transaction" rule, which requires the utility to pay the cogenerator at full avoided cost for power which the utility does not receive or use.

ing references to the subject of monopsony power, which appears at the end of the full avoided cost part of its opinion. *See* FERC Br. at 24-27. Yet, the court expressly recognized that these remarks were only *dicta*, characterizing them at the outset as "some additional concerns raised by the full avoided cost rule," mentioned only in the context of the remanded rulemaking. Pet. App. at B-12. As the court specified in denying rehearing, these concerns were only "suggested considerations" for the Commission on remand which the court realized "may indeed have ready answers" that "should not be burdensome for FERC to supply." Pet. App. at B-204. These remarks, the court explained (Pet. App. at B-16), did not affect its holding, for

> even if utilities are monopsonists, it does not necessarily follow that the proper rate is at full avoided cost. Again, the Commission must explain why the level was set here rather than somewhere else.

II. THE INTERCONNECTION RULE IS UNLAWFUL

An "interconnection" is a physical connection allowing electricity to flow from one entity to another and is required to enable a cogenerator to sell electricity to a utility.[47] Congress recognized this and, in sections 202 and 204 of PURPA, added sections 210 and 212 to the Federal Power Act, authorizing the FERC, *inter alia*, to order interconnections between cogenerators and utilities if certain conditions are met, including those to protect the safety and reliability of the electric transmission network. Congress further specified, in PURPA section 210(e)(3)(B), that the FERC may *not* exempt qualify-

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[47] The only interconnections at issue are those necessary to enable a qualifying facility to transfer electricity *to a utility*. *See* Pet. App. at B-20; pp. 41-43, *infra*. Because these involve adding electricity to the network of utility grids, they have the potential to cause technical difficulties affecting safety and reliability. Standard interconnections to enable utilities to transfer power *to cogenerators* do not cause these kinds of difficulties and are not in dispute.

ing facilities from the provisions of these newly added sections of the FPA.

The FERC, relying on its authority to issue rules "necessary to encourage cogeneration" under section 210(a) of PURPA, has directed utilities, on a blanket basis, "to make such interconnections with any qualifying facility as may be necessary to accomplish purchases or sales under [the FERC's cogeneration rules]." 18 C.F.R. § 292.303(c)(1). The court of appeals found that this rule exempted cogenerators from the specific conditions imposed by FPA sections 210 and 212, contrary to the prohibition against such an exemption contained in section 210(e)(3)(B) of PURPA.

The FERC argues that this decision by the court of appeals, like its decision vacating the full avoided cost rule, is based on a misperception of the statutory scheme and that the effect would be to "paralyze" the cogeneration program. FERC Br. at 35, 43. Neither contention is valid. The Commission's argument that section 210(a) of PURPA provides an independent basis for ordering interconnections ignores the plain language of the statute and the legislative history, both of which confirm that Congress intended to deal with cogeneration interconnections through the comprehensive authority of FPA sections 210 and 212. The argument that compliance with these provisions will prejudice the cogeneration program is unfounded and, in any event, is not a sufficient basis for a rule which conflicts with the express terms of the statute.

A. The Rule Would Exempt Qualifying Facilities From the Requirements of Section 210 of the Federal Power Act, Contrary to the Explicit Statutory Limitation Contained in Section 210(e)(3)(B) of PURPA

In resolving issues of statutory construction, the starting point is the language of the statute. *Southeastern Community College v. Davis*, 442 U.S. 397, 405 (1979).

Here, the pertinent sections of PURPA (including sections 202 and 204 which added sections 210 and 212 of the FPA) indicate plainly that Congress intended to deal with interconnection for cogenerators under section 210 of the FPA.

FPA section 210(a)(1), 16 U.S.C. § 824i(a)(1) (Supp. V), expressly authorizes the Commission to issue an order that a utility interconnect with a qualifying facility "Upon application of any . . . qualifying cogenerator, or qualifying small power producer." Once the FERC receives an application for an interconnection order, it is to "afford an opportunity for an evidentiary hearing" and determine whether specified substantive standards are met.[48]

PURPA section 210 confirms Congress' intent to rely upon FPA section 210 to provide cogenerators with the means to obtain necessary interconnection orders. Thus, while PURPA section 210(e) authorizes the FERC to exempt qualifying facilities from provisions of the FPA, section 210(e)(3)(B) expressly precludes the Commission from exempting them from "the provisions of sections 210, 211, or 212 of the Federal Power Act or the necessary authorities for enforcement of any such provision under the Federal Power Act."

Against this statutory background, the FERC promulgated rule § 292.303(c)(1), 18 C.F.R. § 292.303(c)(1),

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[48] FPA § 210(b), 16 U.S.C. § 824i(b) (Supp. V). Under FPA § 210(c), 16 U.S.C. § 824i(c) (Supp. V), the FERC is to determine whether the requested interconnection order: (1) is in the public interest; (2) would encourage conservation of energy or capital, optimize the efficiency of the use of facilities and resources, or improve the reliability of any utility system to which the order applies; and (3) meets the requirements of FPA § 212. These requirements include that the order will not: likely result in an uncompensated economic loss by, or place an undue burden on, any party; unreasonably impair any utility's reliability; or impair any utility's ability to render adequate service to its customers. By contrast, the Commission's rules only address the issue of cost. 18 C.F.R. § 292.306.

which exempts cogeneration facilities from the need to comply with the safeguards specified in FPA sections 210 and 212. The rule thereby deprives FPA section 210(a) and PURPA section 210(e)(3)(B) of any meaning. *See, e.g., American Textile Manufacturers Institute*, 452 U.S. at 513. As the court of appeals held, this rule "is inconsistent with the statutes" (Pet. App. at B-22); thus, it must be rejected. *Democratic Senatorial Campaign Committee*, 454 U.S. at 32.

The FERC attempts to overcome the direct conflict between the statute and its rule by arguing (1) that the legislative history demonstrates that sections 210 and 212 of the FPA are addressed to an "entirely distinct" problem, FERC Br. at 37; and (2) that inferring authority to order interconnections under section 210(a) of PURPA is "absolutely essential to make the program work," FERC Br. at 43. We address each of these contentions below, along with other arguments offered to support the rule.

B. The Legislative History Establishes that Congress Chose FPA Section 210 As the Means to Provide for Interconnections of Qualifying Facilities

1. *Contemporaneous Constructions of the Legislative Language Demonstrate That Congress So Understood FPA Section 210*

While it ordinarily is unnecessary to rely upon legislative history where the meaning of the statutory language is clear, *Consumer Product Safety Commission v. GTE Sylvania, Inc.*, 447 U.S. 102, 108 (1980),[49] since the Commission's principal defense of its rule is based upon its misreading of the legislative history, we now turn to that subject. There is no dispute that Congress intended there to be a means to compel a utility to interconnect with a cogenerator in appropriate cases. The

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[49] *See Rodriguez v. Compass Shipping Co.*, 451 U.S. 596, 614 & n.33 (1981).

clear and direct statements in the legislative history show that FPA section 210 was intended to be that means. The bill proposed by the Administration,[50] like the final version of PURPA, contained a comprehensive provision dealing with interconnection, which required evidentiary hearings, and explicitly applied to cogenerators. This provision (section 521[51]), which became FPA section 210, was separate from the provision dealing with cogeneration (section 522) which did not mention interconnections. In describing this bill to Congress, the drafters explicitly stated that qualifying facilities would obtain any necessary interconnection through section 521, rather than through section 522, the cogeneration provision that was the precursor to PURPA section 210.

Thus, David Bardin, Deputy Administrator of the Federal Energy Administration and a principal spokesman on behalf of the Administration bill, stated that the bill provided "*the Federal Power Commission* comprehensive authority to require interconnection between utilities and cogenerators. . . ."[52] Mr. Bardin's reference to the Commission makes it unmistakable that he was referring to the bill's interconnection provision, section 521, rather

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[50] H.R. 6831 (May 2, 1977) and S. 1469 (May 5, 1977).

[51] Section 521 provided in pertinent part:

> (b)(1) Whenever the Commission, on its own motion, or upon application of any State commission or of any electric utility or any qualifying cogenerator . . . and after notice . . . and after evidentiary hearing, finds such action necessary or appropriate in the public interest, it shall by order direct an electric utility . . .
>
> > (A) to establish physical connection of its transmission facilities with the facilities of any other electric utility or qualifying cogenerator. . . .

[52] *Public Utility Rate Proposals of President Carter's Energy Program: Hearings on S. 122, S. 1300, S. 1363, S. 1364, S. 1469 (Part E) Before the Subcommittee on Energy Conservation and Regulation of the Senate Committee on Energy and Natural Resources*, 95th Cong., 1st Sess., (Senate Hearings) Pt. 1, at 187.

than to its cogeneration provision, section 522, since section 522 required the Federal Energy Administration (FEA), rather than the Federal Power Commission (FPC), to promulgate rules "requiring electric utilities to offer to sell electric energy to any qualifying cogenerator and to offer to purchase electric energy from such cogenerators." Mr. Bardin's testimony describing the bill to the House subcommittee likewise made clear that section 521 (which became FPA 210) was the means for ordering interconnections between cogenerators and utilities to effectuate the cogeneration provision of section 522 (which became PURPA section 210):

> Further, the bill would provide general comprehensive authority for the Federal Power Commission to order interconnection. . . .
>
> . . .
>
> The bill further would provide authority for the Administrator of FEA to insure that utilities buy and sell electricity at non-discriminatory rates to industries that could generate electricity *and provide authority to the Federal Power Commission to order utilities to allow such industries to interconnect with the utility system*. . . .[53]

The Congressional Office of Technology Assessment prepared an *Analysis of the Proposed National Energy Plan, August 1977*. That *Analysis* demonstrates that Congress understood the Administration bill to address in section 521 the cogeneration interconnections required to effectuate the purchases and sales authorized by section 522 (*id.* at 129; emphasis supplied):

> The proposed legislation contains a number of features which either remove obstacles to or provide incentives for the practice of cogeneration by industry. Sec. 521 enables any qualifying cogenerator to

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[53] *Hearings on H.R. 6831, et al. Before the Subcommittee on Energy and Power of the House Committee on Interstate and Foreign Commerce*, 95th Cong., 1st Sess. (House Hearings), Part 3, vol. 1, at 74 (1977) (emphasis supplied).

> intertie with utility transmission facilities in order to sell surplus power and buy backup power at fair prices. In Sec. 522, qualifying cogenerators are assured fair rates *in the above transactions*. . . .

During markup, the House Committee essentially substituted the provisions of H.R. 6660 for those of the Administration bill dealing with interconnection and cogeneration. Those provisions were quite similar to those of the Administration bill concerning interconnection, with two exceptions. First, this House bill directed the FPC, and not the FEA, to prescribe purchase and sale rules; and, second, it required these rules to include "rules respecting the interconnection of a qualifying cogeneration facility to the distribution system of any electric utility or to a centrally dispatched power pool. . . ."[84] H.R. 6660, § 101(b) (April 26, 1977); Committee Print, June 28, 1977 (J. 91-845), § 546(a)(2). (This version of the bill became known as H.R. 8444 (July 20, 1977)).

Even after the provisions of this bill were largely substituted for those of the original Administration bill, the legislative history demonstrates that Congress understood the precursor to FPA section 210 (H.R. 8444, § 541) to be the mechanism for providing interconnections for cogenerators whose purchases and sales were the subject of that bill's section 546, its precursor to PURPA section 210. For example, the Chairman of the FERC testified before a House Subcommittee concerning section 541:

> Enactment of H.R. 8444 would represent an important step in providing the Commission with the legislative mandate and the necessary authority to carry out the responsibility for assuring adequate, reliable bulk power supply. Three sections of this Bill are especially important in this regard: Sections 541, 542, and 545.

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[84] The language referring to interconnections with distribution systems was removed from the cogeneration provision by the Conference Committee, thus returning the material language to the form it took in the Administration bill. See pages 41-43, *infra*.

> Section 541 extends the authority of the Commission under Section 202(b) of the Federal Power Act in six ways:
>
> > . . . (3) The Commission would be empowered to act upon application of any qualified cogenerator. This provision recognizes the need to encourage cost-effective cogeneration and constitutes an important step in removing obstacles to such expanded cogeneration.[55]

2. *The Action of the Conference Committee Confirms the Illegality of the Commission's Rule*

While the Conference adopted much of the House version of the interconnection and cogeneration portions of the legislation (FERC Br. at 44), it did make two pertinent changes. First, the Conference deleted that part of what became PURPA section 210 which would have directed the Commission to promulgate rules respecting interconnection with "distribution facilities" of an electric utility.

The Commission argues that this deletion of the reference to interconnection in PURPA section 210's precursor demonstrates that PURPA section 210 nonetheless grants the Commission implied authority to order interconnections thereunder because "Congress viewed the obligation to interconnect as subsumed within the obligation to purchase and sell, which was retained. . . ." FERC Br. at 44. The Commission's contention is unfounded.

As the court of appeals noted, "[t]he interconnections at issue here are not the usual ones by which a customer

---

[55] *Hearing on the New York City Blackout of July 13, 1977 Before the Subcommittee on Energy and Power of the House Committee on Interstate and Foreign Commerce*, 95th Cong., 1st Sess. (Blackout Hearing) at 162, 165 (1977) (statement of Charles Curtis). The Subcommittee used the hearing as a vehicle to undertake a thorough review of the interconnection provisions of the pending legislation. *See also* House Hearings at 601 (Response to subcommittee questions furnished by the FPC).

takes power *from* a utility but rather those which permit a cogenerator to transmit electricity *to* a utility." Pet. App. at B-20 (emphasis in original). The "usual" kind of interconnection by which a customer takes electricity from a utility involves the *distribution* facilities of the utility. By contrast, the interconnections at issue under the Commission's rule involve those necessary to permit cogenerators to *transmit power to* an electric utility. Such interconnections are with the *transmission* facilities of the electric utility.[66]

FPA section 210 and all its precursors uniformly related to interconnections with the *transmission* facilities of electric utilities—that is, with the type of interconnection at issue here. The only reference to interconnections in the precursor to PURPA section 210 was the pre-Conference direction in the House bill that the rules under that section encompass interconnections with the *distribution* facilities of utilities—that is, interconnections to enable utilities to sell power to cogenerators, and not the interconnections necessary to enable cogenerators to sell to utilities that were always the subject of FPA

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[66] The Commission's own regulations define the term "transmission system" to mean:

> . . .
>
> (3) All lines and equipment whose primary purpose is to augment, integrate or tie together the sources of power supply.

18 C.F.R. Part 101, Electric Plant Instruction No. 14(A). Since the lines and equipment whose primary purpose is to bring additional electricity *into* the utility system "augment . . . the sources of power supply," they are "transmission facilities." Instruction No. 14(B) defines the term "distribution system" to mean "all land, structures, conversion equipment, lines, line transformers, and other facilities employed between the primary source of supply (i.e., generating station, or point of receipt in the case of purchased power) and of delivery to customers, *which are not includible in transmission system, as defined in paragraph A. . . .*" (emphasis supplied).

section 210. Thus, even if the Conferees' deletion of the "distribution facilities" interconnection language could reasonably be inferred to have left authority over such interconnections in place under PURPA section 210, that authority is confined to "usual" interconnections that are not the subject of the present dispute.[57]

Second, the Conference took one other significant action. It added, in section 210(e)(3)(B), the express prohibition against exempting qualifying cogenerators from FPA sections 210 and 212. By adding the non-exemption provision at the same time that it deleted all reference to interconnections of any kind from PURPA section 210, Congress re-confirmed its intent that FPA sections 210 and 212 were to be the means to assure necessary interconnections between cogenerators and utilities while protecting the safety and reliability of the utility system.

C. The Constructions Urged by Petitioners Do Not Survive Examination

The Commission contends that it has authority, independent of FPA sections 210 and 212, to order interconnection under section 210(a) of PURPA. The Commission's argument is that, since interconnections are necessary for cogenerators to sell to utilities, and since PURPA section 210(a) directs it to promulgate purchase and sale rules "necessary to encourage cogeneration," that section must permit it to override the FPA sections (and to do so in spite of PURPA section 210(e)(3)(B)'s express limitation upon its exemption authority).

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[57] In fact, such an inference would seem improper. As it came to Conference, § 546 of H.R. 8444 enumerated five subjects to be included in the Commission's cogeneration rules, of which two (including interconnections with distribution facilities) were deleted. *Compare* H.R. 8444, § 546(a)(3)-(5) *with* PURPA § 210(a). To draw the inference suggested by the FERC requires the assumption that Congress meant to leave the Commission's authority over these five areas unchanged, even though it went to the trouble of deleting two while leaving the other three in place. FERC Br. at 44.

The Commission cites no authority for this claim that section 210(a) authorizes interconnections. It is premised on the FERC's misreading of the legislative history and its belief that PURPA section 210 and FPA sections 210 and 212 address "entirely distinct" matters. FERC Br. at 37. As we have shown, however, Congress provided comprehensive interconnection authority in the FPA sections it enacted as part of PURPA, and Congress intended those provisions to provide the means for cogenerators to obtain necessary interconnections. It would be utterly inconsistent with the structure of the statute to imply independent interconnection authority under PURPA section 210(a).[58]

Congress carefully constructed checks and balances in FPA sections 210 and 212 to assure that whatever interconnections were ordered would promote efficiency while protecting the safety and reliability of the utility. To infer that Congress intended PURPA section 210(a) to be independent authority without any mention of interconnection in the section, and without any support in the legislative history,[59] reflects the Commission's failure to

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[58] The FERC's construction would make the inclusion of cogenerators among those eligible to apply for an interconnection order under FPA § 210 surplusage. The FERC's brief attempts to show that its construction would not do so by offering two examples of cogenerators as applicants for interconnection orders other than those made unnecessary by the FERC's rules (FERC Br. at 38 n.39), but neither is correct. Its first example—to allow a cogenerator to use the lines of another such facility "to transmit power to a more distant utility" (*i.e.*, "wheeling")—is specifically dealt with in FPA § 211, not § 210. Under § 211, cogenerators are not among those eligible to apply for such an order. The second example—to allow a cogenerator selling power at retail under state regulation to obtain an additional supply of power it could draw upon to sell to *its* customers—is itself surplusage since a qualifying facility buying power for resale would be a "utility" under the FPA, and thus able to apply for such an order as a utility.

[59] *See* pages 37-41, *supra*. Diamond Shamrock's argument that PURPA § 210(f) inferentially authorizes the interconnection rule

"look to the provisions of the whole law, and to its object and policy." *Pennhurst State School and Hospital v. Halderman*, 451 U.S. 1, 18 (1981).[60] While section 210(a) generally speaks of "rules . . . necessary to encourage cogeneration," such a "relatively *general grant* of authority" is controlled by the "relatively *specific limitation* on authority" of PURPA section 210(e)(3)(B), and "does not give the Commission a mandate to consign detailed provisions of PURPA itself to a wastebasket as meaningless surplusage." Pet. App. at B-24 (emphasis is the court of appeals').[61]

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is unpersuasive for the same reasons as the Commission's argument from § 210(a); and, further § 210(f) offers no basis for inferring authority to evade the clear command of § 210(e)(3)(B).

[60] Thus, even if PURPA § 210(e)(3)(B) did not exist, the Commission's interconnection rule still would be illegal.

[61] *See Clifford F. MacEvoy Co. v. United States*, 322 U.S. 102, 107 (1944). The "general grant of authority" referred to by the court of appeals included both PURPA § 210(a) (see Pet. App. at B-23), and FPA § 212(e), which provides that FPA § 210 does not limit, impair, or otherwise affect any authority of the Commission "under any other provision of law." Pet. App. at B-59. The FERC's assertion in the Order (which it has not advanced to this Court) that Congress intended this general savings clause to overcome the specific limitation in PURPA § 210(e)(3)(B) would violate the fundamental precept of statutory construction that all parts of a statute are to be given effect. *American Textile Mfrs. Inst.*, 452 U.S. at 513. PURPA § 210 is *not* a part of the FPA, and yet the Conference Report's discussion of the scope of the savings clause was confined to the FERC's authority under the FPA:

> Subsection (e) of new section 212 expresses the intention of the conferees that the authorities granted in sections 210 and 211 are in addition to and not in lieu of other authority the Commission may have *under the Federal Power Act.*

Conference Report at 94 (emphasis added). Such other provisions of the FPA include §§ 202(c) and 202(d), 16 U.S.C. §§ 824a(c), 824a(d) (Supp. V). Had the Conference Committee that adopted both PURPA § 210(e)(3)(B) and FPA § 212(e) intended the former to be limited by the latter, it would not have so confined its description of the scope of the savings provision.

The Commission's Order on Rehearing attempted to restrict the scope of the broad non-exemption language of PURPA section 210(e)(3)(B) by claiming that the provision contains an unexpressed distinction, that it only applies where a cogenerator is a "target" of an interconnection application, not where it is itself the "applicant." The Commission's explanation for this strained construct was that

> To "exempt" qualifying facilities does not mean to deny them a privelege [sic] or right to which they would otherwise be entitled; to exempt means to relieve of undesirable responsibility or obligation.

Pet. App. at B-181. The Commission reasoned that a cogenerator applying for an order sought a privilege (*i.e.*, a benefit) to which exemption was, on its theory, inapplicable, while a cogenerator that is a "target" of the application is subject to an "undesirable responsibility or obligation" (*i.e.*, a burden) to which the prohibition of exemption in section 210(e)(3)(B) would apply. Pet. App. at B-181-82.

None of the provisions of PURPA or the FPA contain any basis for this artificial distinction, nor does the legislative history. In fact, the Commission's strained construct would engraft a confusing limitation on an otherwise directly phrased statute.[62] In its brief on the merits, the FERC seems to abandon this elusive, indeed illusory, distinction.[63] The "burdens" and "benefits" contained in

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[62] The FERC's effort to explain its own burden-benefit argument (FERC's Petition for a Writ of Certiorari, Dkt. No. 82-226 [FERC Pet.] at 15), itself demonstrates the confusion created by this strained interpretation.

[63] The Commission now asserts that PURPA § 210(e)(3)(B) was intended only to prevent the Commission from reopening the "regulatory gap" eliminated by FPA § 210's extension of Commission power to otherwise nonjurisdictional electrical generators. FERC Br. at 45. This assertion depends entirely on the Commission's mistaken belief (discussed at pages 37-41 that Congress intended FPA § 210 to address "entirely distinct" concerns from those addressed in PURPA § 210.

FPA sections 210 and 212 are inextricably intertwined, in that an applicant seeking interconnection can obtain that benefit only by satisfying the supposedly burdensome requirements.[64] In seeking to deprive PURPA section 210(e)(3)(B) of meaning, it is the petitioners and not the respondent utilities that fail to construe the statutory provisions to give full effect to the statute as a whole, *see Market Co. v. Hoffman*, 101 U.S. 112 (1879); *Iglehart v. Iglehart*, 204 U.S. 478 (1907); and *Clark v. Uebersee Finanz-Korporation, A.G.*, 332 U.S. 480 (1947); and, it is petitioners that seize upon a few general words to nullify specific conditions and requirements enumerated in the statute. *See Pennhurst State School and Hospital*, 451 U.S. at 18.

Had Congress wanted to limit the section's reach to qualifying facilities as targets only, it could have excluded them from the class of applicants.[65] Yet, FPA section 210 expressly provides that cogenerators may be both targets and applicants for interconnection orders.

D. The Contention that the Rule Has Harsh Policy Consequences Is Unfounded and In Any Event Does Not Justify Ignoring the Statutory Requirements

Petitioners and their *amici* supporters claim that the interconnection rule is necessary to avoid harsh policy consequences. Their claim is unfounded, and in any event would be insufficient to justify a rule that conflicts with the express terms of the statute.

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[64] The artificial nature of the burden-benefit distinction is underscored by Petitioners' own argument, in which they claim that the consequence of qualifying facilities' not being exempted from what they see as the benefit side of the issue (being able to interconnect) is that they will thereby endure what they claim will be great procedural burdens. API Br. at 38-41; FERC Pet. at 16.

[65] Congress made the converse of this distinction in its treatment of Federal power marketing agencies, including them as applicants for, but not as targets of, interconnection orders. *See* FPA § 210(a)(1)(A), 16 U.S.C. § 824i(a)(1)(A) (Supp. V).

Petitioners assert that hearings on interconnection orders under FPA section 210 would so burden affected cogenerators as to disrupt the entire program. But, FPA section 210(b)(2), 16 U.S.C. § 824i(b)(2) (Supp V), directs the Commission to "afford an opportunity for an evidentiary hearing," not to hold a hearing in all cases. As the cases cited by Kerr-McGee (Br. at 28-29) demonstrate, such a requirement often can be satisfied without an actual hearing—for example, only holding a hearing where the opposing party raises factual objections that are material under the statute.[66] Furthermore, as the Commission suggests in its brief (at 38-39), it might be able to determine generically and by rulemaking that qualifying facilities necessarily satisfy some of the requirements of FPA section 210, so that these questions would be eliminated as subjects of case-by-case consideration. *See Weinberger v. Hynson, Westcott & Dunning, Inc.*, 412 U.S. 609, 620-22 & n.17 (1973).

Petitioners' argument fails to recognize that Congress created the substantive and procedural requirements of FPA section 210 for important reasons. The legislative history reveals that Congress was acutely aware that interconnection involved complex technical issues which, if not properly resolved, could threaten the reliability and safety of the utility system.[67] Indeed, during the legisla-

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[66] API's claim that contested interconnection hea.ings at the FERC are now lengthy is based solely on cases concerning interconnections among utility systems (there having been, under the rule, no proceedings involving interconnections between cogenerators and utilities). While significant technical issues may be in dispute in proceedings involving cogenerators, those issues will be fewer in number and generally less complex than when interconnections among utilities are in dispute. The case of *Central Power & Light Co.*, 14 F.E.R.C. (CCH) ¶ 63,077 at p. 65,232 (1981), cited by API, is atypical even for inter-utility interconnections. It involved the "Texas problem," which was the subject of extensive litigation and Congressional concern prior to the passage of PURPA.

[67] *See, e.g.*, Blackout Hearings at 116-17 (Statement of FERC Chairman Curtis); *see also* 123 Cong. Rec. at 32397 (1977) (statement of Senator Johnston).

tive hearings, several witnesses specifically tied these concerns to interconnections between cogenerators and utilities.[68]

Because of these concerns over reliability and safety, Congress recognized that interconnection is an intrinsically federal concern. For example, addressing a proposed amendment dealing with interconnection and wheeling, Senator Durkin stated:

> I have argued quite strenuously today on the floor that the lowest level of government that can get the job done should be the highest level to get the responsibility. But this is one area, I think, where the federal presence is required. It is a problem that can only be resolved by the Federal Government, and I believe it is consistent with the approach I have taken to the utility regulatory reform proposals that we have been wrestling with in the past couple of days.[69]

Finally, assertions that the requirements of FPA section 210 are burdensome or that Congress' concern with the effects of cogenerator interconnections on the safety and reliability of utility transmission systems might have been misplaced cannot sustain the rule. Congress, and not the courts, "is the appropriate body to weigh the relevant, policy-laden considerations. . . ." *Bob Jones University v. Simon*, 416 U.S. 725, 750 (1974).

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[68] *See, e.g.*, House Hearings at 330 (Statement of George Oprea, Houston Lighting & Power Co.); *Id.* at 364 (Statement of Gerald Decker, Dow Chemical Co.).

[69] 123 Cong. Rec. 32675 (1977). *See also* 123 Cong. Rec. 31300 (1977) (statement of Representative John Dingell).

CONCLUSION

The judgment of the court of appeals should be affirmed.

Respectfully submitted,

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Nos. 82-34 and 82-226

IN THE

Supreme Court of the United States

OCTOBER TERM, 1982

AMERICAN PAPER INSTITUTE, INC., *Petitioner*

v.

AMERICAN ELECTRIC POWER SERVICE CORPORATION, *et al.*

FEDERAL ENERGY REGULATORY COMMISSION, *Petitioner*

v.

AMERICAN ELECTRIC POWER SERVICE CORPORATION, *et al.*

On Writs Of Certiorari To The United States Court Of Appeals For The District Of Columbia Circuit

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BRIEF FOR RESPONDENT ELIZABETHTOWN GAS COMPANY IN SUPPORT OF PETITIONERS

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On Writs Of Certiorari To The United States Court Of Appeals For The District Of Columbia Circuit

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BRIEF FOR RESPONDENT ELIZABETHTOWN GAS COMPANY IN SUPPORT OF PETITIONERS

Elizabethtown Gas Company ("Elizabethtown"), intervenor in the court below, filed a brief in support of the petition for writ of certiorari in No. 82-34. Elizabethtown here urges the Court to grant the relief sought by petitioners in both captioned cases.

PRELIMINARY STATEMENT

Elizabethtown is a public utility organized and existing under the laws of the State of New Jersey.[1] Under regulation by the New Jersey Board of Public Utilities, Elizabethtown engages in the sale and distribution of gas in 68 municipalities serving over 190,000 customers. Elizabethtown competes in its service area with electric utilities supplying the energy needs of residential, commercial and industrial end users.

Elizabethtown is an actual supplier of gas to cogeneration facilities and a potential supplier of gas to cogeneration facilities which could qualify for the benefits of the Public Utility Regulatory Policies Act of 1978 ("PURPA"), Pub.L. No. 95-617, 92 Stat. 3117.[2]

Petitioners challenge the decision of the court below insofar as it vacated two of the rules set out in Federal

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[1] Elizabethtown is a subsidiary of National Utilities & Industries Corporation and has as affiliates Achter Kol Corporation, National Computer Utility Company, Enercorp Resources, Inc., Utility Propane Company, National Gas Gathering Company, National Energy Leasing Company, National Enerdrill Corporation, and The Lenape Resources Corporation.

[2] The relevant provisions of PURPA are reproduced on pages A-7 to A-19 of Appendix A to the petition for writ of certiorari in No. 82-34. Section 201 of PURPA required the Federal Energy Regulatory Commission to establish criteria under which cogeneration and small power production facilities could qualify for PURPA benefits. The Commission's Order No. 70, as amended, setting forth those criteria is not before this Court. The text of Order No. 70 is reproduced on pages B-120 to B-199 of Appendix B to the petitition in No. 82-34.

Energy Regulatory Commission ("FERC") Order No. 69 which implemented Section 210 of PURPA.[3]

Elizabethtown accepts, for purposes of this brief, Petitioners' statements of questions presented, lists of parties to the proceeding below, statements of opinions below, statements of jurisdiction, lists of statutory and regulatory provisions involved, and statements of the case.

SUMMARY OF ARGUMENT

Cogeneration facilities are ordinarily far more fuel-efficient than are public utility steam electric power generating plants. Such cogeneration facilities can provide a decentralized, competitive source of bulk electric power for local distribution at a time of rising electric bills. They can create a competitive market for sellers of fuels utilizable in cogeneration facilities.

The construction of cogeneration facilities has been stifled by the lack of assured outlets at reasonable prices for the surplus power they generate. The two rules nullified by the lower court helped overcome that handicap. Under those rules electric utilities were required to interconnect with qualifying cogeneration facilities, and to pay a price for surplus power which is no higher than their full avoided costs of electric energy from other sources.

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[3] Section 210(a) directed the Commission to prescribe rules which it deemed necessary to establish relationships between qualifying facilities and electric utilities "to encourage cogeneration and small power production". 16 U.S.C. § 824a-3(a). Order No. 69, as amended, implementing this provision, is reproduced on pages B-38 to B-119 and B-175 to B-199 of Appendix B to the petition in No. 82-34.

Unless the rules are reinstated, the purpose of Section 210(a) of PURPA "to encourage cogeneration and small power production" will be frustrated.

ARGUMENT

1. It is more efficient to use fossil fuels in a cogeneration unit than to use them in a typical public utility electric power generating plant. This is because the steam utilized in the latter is condensed after passing through the electric-generating turbines instead of being put to some other industrial or commercial use. The Commission found: "Cogeneration facilities use significantly less fuel to produce electricity and steam (or other forms of energy) than would be needed to produce the two separately."[4]

The fact that the distribution of electricity must be a monopoly does not mean that the generation, transmission and distribution functions in the industry must be vertically integrated, or that competition is not possible at the generation level.[5]

Historically, monopoly at the generation level has been fostered by technical characteristics of the utility industry: huge quantities of capital in long-lived and inflexible facilities directly connected to consumers and the ex-

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[4] Commission Order No. 69, page B-39 of Appendix B to petition in No. 82-34. A further benefit expected from cogeneration plants is reduced transmission losses due to the proximity of the plant to the load center utilizing the electricity. (R. 2292)

[5] *Otter Tail Power Co.* v. *United States*, 410 U.S. 366 (1973). See 2 A. Kahn, *The Economics of Regulation: Principles and Institutions* 18-19 (1971); Meeks, "Concentration in the Electric Power Industry: The Impact on Antitrust Policy," 72 *Colum. L.Rev.* 64, 82 (1972).

istence of substantial economies of scale in the bulk power plants.[6] In recent years, costs of constructing generation facilities have been increasing faster than the general level of inflation, causing unit costs and rates to increase steadily.[7]

Cogeneration facilities offer a modest antidote to this trend. They involve relatively small outlays of capital, by persons outside the public utility industry. They offer much more economic use of fuel in an economy which has seen fuel costs of electric utilities push rates to very high levels.

The Commission's rulemaking program might result in the construction of 12,000 MW of new capacity by qualifying facilities by 1995. This could cause electric utilities to defer or cancel construction of eleven 500 MW coal-fired steam plants, one 1,000 MW nuclear plant, a number of 75 MW gas turbines, and certain large scale hydro and combined cycle installations. The environmental consequences of constructing and operating these plants could be avoided.[8]

About 25 percent of the PURPA-induced cogeneration in the *industrial* sector is expected to be installed in the Middle Atlantic area which includes New Jersey. The

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[6] See Bonbright, J., *Principles of Public Utility Rates* 8-17 (1961).

[7] U. S. Department of Energy, *The National Power Grid Study*, Vol. 1, Final Report, DOE/ERA-0056-1, pp. 22-23 (1980). Approximately two-thirds of the capital outlays of electric utilities is attributable to the construction of generation facilities; up from forty percent in the mid 1960's. This dramatic shift is due to a very rapid rise in construction costs and delays in construction schedules. *Id.* at 18, 54.

[8] Order No. 70, page B-140 of Appendix B to petition in No. 82-34.

three largest industrial segments likely to participate in PURPA-induced cogeneration are the pulp and paper, chemical, and petroleum refining industries. The chemical industry anticipates using natural gas in gas-fired combustion turbines and, with process-derived fuels, in steam-topping cycle engines. Pulp and paper plants would use gas and oil as fuel for cogeneration to augment wood and other process by-products.[9]

PURPA-induced *commercial* cogeneration is expected to occur almost exclusively in the Middle Atlantic area and to take the form primarily of diesel engines and dual-fuel engines. Natural gas would be used in dual-fuel use engines when available and less expensive than diesel fuel.[10]

Gas distribution companies indicated during the rulemaking process an interest in supplying PURPA-induced cogeneration.[11] Efforts by the electric utilities to prevent the use of natural gas in such facilities were rejected by the Commission and by the Court of Appeals.[12]

The cogeneration rules were intended to provide competitive cogeneration sources for bulk electric power. The Commission found: "By obtaining electric energy from cogeneration and small power production, utilities

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[9] R. 2292.

[10] *Ibid.*

[11] R. 389-390, 712-719, 1412-1430, 2317-2319.

[12] *American Electric Power Service Corp.* v. *Federal Energy Regulatory Commission*, 675 F.2d 1226, 1241-5 (D.C. Cir. 1982), *reh. denied*, 675 F.2d at 1246.

can reduce the burning of fuel and construction of plants than would otherwise be required."[13]

2. The installation of fuel-efficient cogeneration facilities has been stultified because of the lack of assured interconnections with electric utilities which might serve as a market for surplus electric power from the cogeneration facility, and a pricing mechanism for surplus power which would facilitate the economic planning of new cogeneration facilities.[14]

Those considering the installation of cogeneration facilities in industrial plants and at commercial sites are not in the business of generating electricity for public consumption. Decisions as to the type of facilities to be installed and the fuel to be used are governed by manufacturing and commercial concerns which cannot await the uncertain outcome of drawn-out litigation with electric utilities in the administrative arenas. The prospect of traversing an assuredly expensive and possibly barren path through the administrative agency/court maze, should they choose the cogeneration option, is enough to effect rejection of that business choice.

If cogeneration is to be encouraged as a source of bulk electric power for the public, as we submit Congress intended in enacting PURPA, then access to the electric distribution systems must be simple and the economics of that course certain. Those objectives cannot be achieved without reversing the court below.

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[13] R. 1217.

[14] Commission Order No. 70, page B-121 of Appendix B to petition in No. 82-34.

Consolidated Edison Company of New York, Inc., petitioner in the court below, serves with electricity a territory The Brooklyn Union Gas Company serves with gas. None of the gas-fired cogeneration facilities in Brooklyn Union's territory was connected with Consolidated Edison's electric distribution system.[15] Brooklyn Union advised the Commission in the rulemaking proceeding:

> Among those parties most vociferously opposing the use of natural gas for "inferior" cogeneration purposes are electric utilities which are actively engaged in dissipating this nation's "gas bubble" by using gas as boiler fuel in the generation of electricity. In light of the efficiency standards which the Commission has proposed for gas-fired CFs [cogeneration facilities] which seek qualifying facility status, Brooklyn Union submits that the twin goals of conserving natural resources and maximizing fuel use efficiency could be better achieved by use of natural gas in CFs which meet the Commission's efficiency standards and the termination, at the *earliest possible date*, of programs which encourage or permit consumption of vast quantities of natural gas in comparatively inefficient utility central electric generating stations.[16]

The electric utilities successfully persuaded the court below to interpret PURPA in a way that needlessly suppresses opportunities for competition in the bulk electric power industry, where competition can and ought exist.[17]

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[15] R. 1413.

[16] R. 1418.

[17] See *Cantor* v. *Detroit Edison Co.*, 428 U.S. 579 (1976); *Otter Tail Power Co.* v. *United States*, *supra*; *Gainesville Utilities Department* v. *Florida Power and Light Co.*, 573 F.2d 292 (5th Cir. 1978), *cert. denied*, 439 U.S. 966 (1978).

If cogeneration is not used, a factory or commercial establishment would utilize a low-pressure steam boiler, or a furnace, to obtain its thermal requirements, and would purchase electricity from the local electric utility.[18] This results in a larger market for the electric utility's own bulk generation, rather than competition in meeting the bulk generation requirements of the utility.

3. "Section 210 of PURPA's Title II . . . seeks to encourage the development of cogeneration and small power production facilities." *Federal Energy Regulatory Commission* v. *Mississippi*, 102 S.Ct. 2126, 2132 (1982). Faced with an obligation to adopt rules encouraging the development of cogeneration, the Commission chose means which would accomplish that result. The lower court did not conclude otherwise.

One may well argue that there are better ways to accomplish that legislative end, ones that are more "fine-tuned" in terms of the concerns of the electric utilities. But that is a proper matter for agency discretion. Although the inquiry "into the facts is to be searching and careful, the ultimate standard of review is a narrow one. The court is not empowered to substitute its judgment for that of the agency." *Citizens to Preserve Overton Park* v. *Volpe*, 401 U.S. 402, 416 (1971).

The Commission's rules were within the granted power, issued pursuant to the proper procedure, and have a reasoned basis. See *Bowman Transportation, Inc.* v. *Arkansas-Best Freight System, Inc.*, 419 U.S. 281, 285 (1974).

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[18] R. 2293.

CONCLUSION

This court should hold that the two rules of the Commission, overturned by the Court below, are the product of reasoned judgment exercised within the ambit of the discretionary judgment delegated by Congress to FERC under PURPA and are valid.

Respectfully submitted,

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Nos. 82-34 and 82-226

In the Supreme Court of the United States

OCTOBER TERM, 1982

AMERICAN PAPER INSTITUTE, INC., PETITIONER

v.

AMERICAN ELECTRIC POWER SERVICE CORP., ET AL.

FEDERAL ENERGY REGULATORY COMMISSION, PETITIONER

v.

AMERICAN ELECTRIC POWER SERVICE CORP., ET AL.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

BRIEF FOR THE FEDERAL ENERGY REGULATORY COMMISSION

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QUESTIONS PRESENTED

In Section 210(a) of the Public Utility Regulatory Policies Act of 1978 (PURPA), Congress directed the Federal Energy Regulatory Commission to issue rules requiring electric utilities to purchase power from and sell back-up power to qualifying cogeneration and small power production facilities and to establish a rate for such purchases and sales. The questions presented are:

1. Whether the Commission's rule establishing the rate at which utilities must offer to purchase power from qualifying facilities at "full avoided cost" satisfies the statutory directive that the Commission adopt a rule that is just and reasonable to electric consumers, in the public interest, and nondiscriminatory in its effects on qualifying facilities.

2. Whether Section 210(e)(3)(B) of PURPA requires the Commission to conduct an evidentiary adjudication under provisions of the Federal Power Act each time it seeks to compel a utility to interconnect with a qualifying facility for the purpose of effectuating the purchases and sales mandated by the Commission's rules under Section 210(a) of PURPA.

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In the Supreme Court of the United States

OCTOBER TERM, 1982

No. 82-34

AMERICAN PAPER INSTITUTE, INC., PETITIONER

v.

AMERICAN ELECTRIC POWER SERVICE CORP., ET AL.

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FEDERAL ENERGY REGULATORY COMMISSION, PETITIONER

v.

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ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

BRIEF FOR THE FEDERAL ENERGY REGULATORY COMMISSION

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. B-1 to B-34)[1] is reported at 675 F.2d 1226. The opinions accompanying the orders denying rehearing and rehearing en banc (Pet. App. B-202 to B-208) are reported at 675 F.2d 1246. The orders of the Commission (Pet. App.

[1] "Pet. App." refers to the appendix to the petition for a writ of certiorari in No. 82-34.

B-38 to B-119, B-120 to B-174 and B-175 to B-199) are reported at 45 Fed. Reg. 12214, 17959 and 33958, respectively.

JURISDICTION

The judgment of the court of appeals (Pet. App. B-200 to B-201) was entered on January 22, 1982. A petition for rehearing was denied on April 9, 1982 (Pet. App. B-202 to B-208). The petition for a writ of certiorari in No. 82-34 was filed on July 8, 1982. The petition for certiorari in No. 82-226 was filed, pursuant to two extensions of time, on August 9, 1982. The petitions were both granted on October 12, 1982. The jurisdiction of this Court rests on 28 U.S.C. 1254(1).

STATUTES AND REGULATIONS INVOLVED

The pertinent statutes and regulations are set forth in an appendix to this brief.

STATEMENT

A. The Statutory Background

This case involves a judicial challenge to certain regulations promulgated by the Federal Energy Regulatory Commission pursuant to Section 210 of the Public Utility Regulatory Policies Act of 1978 (PURPA), 16 U.S.C. (Supp. V) 824a-3. The constitutional validity of the Act, including Section 210, was upheld by this Court in *FERC* v. *Mississippi*, No. 80-1749 (June 1, 1982). As this Court noted in that case, PURPA was enacted as part of a comprehensive legislative package in an effort to "lessen the country's dependence on foreign oil, to avoid repetition of the shortage of natural gas that had been experienced in 1977, and to control consumer costs." *Id.* at 2.[2]

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[2] Senator Jackson, Chairman of the Senate Energy Committee and one of the principal proponents of the legislation in Congress, stated that PURPA was aimed "at promoting conservation of electric energy by consumers, efficient use of facilities and resources by

1. Section 210 of PURPA was enacted to promote development of cogeneration and small power production facilities[3] based on Congress' judgment that "increased use of these sources of energy would reduce the demand for traditional fossil fuels." *FERC* v. *Mississippi*, *supra*, slip op. 6. In adopting this legislation, Congress recognized that two longstanding problems had frustrated the growth of these alternative sources of electric energy: "(1) traditional electric utilities were reluctant to purchase power from, and to sell power to, the non-traditional [generating] facilities; and (2) the regulation of these alternative energy sources by state and federal utility authorities imposed financial burdens upon the non-traditional facilities and thus discouraged their development." *Id.* at 6-7 (footnotes omitted).

In order to overcome the first problem, Congress, in Section 210(a) of PURPA, 16 U.S.C. (Supp. V) 824a-3(a), directed the Commission, within one year of PURPA's enactment, to prescribe "such rules as it determines necessary to encourage cogeneration and small power production," including rules requiring electric utilities to offer to purchase electricity from, and sell electricity to, qualifying facilities. Section 210(b) of PURPA, 16 U.S.C. (Supp. V) 824a-3(b), provides that

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the utility industry, conservation of capital by more effective use of existing plants and equity in ratemaking." 124 Cong. Rec. 34558 (1978).

[3] The statute defines a "cogeneration facility" as a facility that produces both electric energy and steam or some other form of useful energy, such as heat. 16 U.S.C. (Supp. V) 796(18)(A). A "small power production facility" is a facility that has a production capacity of not more than 80 megawatts and uses biomass, waste, or renewable resources (such as wind, water, or solar energy) to produce electric power. 16 U.S.C. (Supp. V) 796(17)(A).

Unless otherwise specified, "cogeneration" denotes both cogeneration and small power production, and "qualifying facility" designates those cogeneration and small power production facilities authorized by statute to sell electricity to and purchase electricity from utilities.

the Commission's rules requiring the purchase by a utility of electricity from a qualifying facility shall insure that the rates for such purchase are: (1) just and reasonable to the utility's customers and in the public interest; and (2) nondiscriminatory with respect to the qualifying cogeneration or small power production facility. Section 210(b) declares that no rule prescribed by the Commission "shall provide for a rate which exceeds the incremental cost to the electric utility of alternative electric energy."[4] Section 210(f) of PURPA, 16 U.S.C. (Supp. V) 824a-3(f), requires each state regulatory authority and nonregulated utility to implement the Commission's rules.

The second barrier that had hindered the development of these nontraditional energy sources was removed by Section 210(e)(1) of PURPA, 16 U.S.C. (Supp. V) 824a-3(e)(1), which authorizes the Commission to exempt qualifying facilities from federal and state regulation as public utilities if it determines that such exemption is necessary to encourage cogeneration and small power production.

2. In addition to its concern with encouraging cogeneration, Congress also was mindful of the problem of "wasteful over-construction of new generating and transmission facilities * * *."[5] It added Sections 210, 211 and 212 of the Federal Power Act ("FPA" or "Power Act")[6] to meet that problem. These provisions of the Power Act granted the Commission new authority to order, inter

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[4] In Section 210(d), 16 U.S.C. (Supp. V) 824a-3(d), Congress defined the term "incremental cost of alternative electric energy" as "the cost to the electric utility of the electric energy which, but for the purchase from such cogenerator or small power producer, such utility would generate or purchase from another source."

[5] 124 Cong. Rec. 34764 (1978) (remarks of Sen. Metzenbaum).

[6] 16 U.S.C. (Supp. V) 824i, 824j and 824k. These sections were added to the Power Act by Sections 202, 203 and 204 of PURPA.

alia, "any electric utility"[7] to "interconnect" or to "wheel" power[8] if such interconnection or wheeling would "further energy conservation[,] efficient use of facilities or * * * improve reliability."[9] "[A]ny cogeneration facility [or] small power production facility" is also subject to a Commission order to interconnect or otherwise coordinate under Section 210 of the Power Act. Section 210 (e)(3)(B) of PURPA further specifies that the Commission may not exempt qualifying facilities from "the provisions of section 210, 211, or 212 of the Federal Power Act * * *." 16 U.S.C. (Supp. V) 824a-3(e)(3)(B).[10] Before compelling interconnection or wheeling under the Power Act provisions, the Commission must determine that such operations are in the public interest and would conserve energy or capital, optimize efficiency, or improve the reliability of the affected utility systems. See 16 U.S.C. (Supp. V) 824i(c), and 824j(a).

The term "electric utility," as used in FPA Sections 210, 211 and 212, includes entities that previously had been outside the Commission's regulatory control, such as state agencies (16 U.S.C. 824(f)) and utilities that do not sell electricity in interstate commerce (16 U.S.C. 824(e)). See note 7, *supra*. Congress extended the new

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[7] For purposes of Sections 210, 211 and 212 of the Power Act, the term "electric utility" is defined as "any person or State agency which sells electricity." 16 U.S.C. (Supp. V) 796(22).

[8] An "interconnection" is a physical connection that permits electricity to flow from one entity to another (Pet. App. B-20). "Wheeling" has been defined as the "transfer by direct transmission or displacement [of] electric power from one utility to another over the facilities of an intermediate utility." *Otter Tail Power Co.* v. *United States*, 410 U.S. 366, 368 (1973).

[9] 124 Cong. Rec. 34558 (1978) (remarks of Sen. Jackson).

[10] Section 210(e)(3) of PURPA also limits the general exemption authority granted to the Commission in Section 210(e)(1) (see page 4, *supra*) by prohibiting the Commission from exempting qualifying facilities both from state laws implementing the cogeneration rules prescribed by the Commission pursuant to Section 210 of PURPA and from the hydroelectric licensing provisions of Part I of the Federal Power Act.

interconnection and wheeling requirements to these entities in part to eliminate the inefficiencies caused by the refusal of some wholly intrastate utilities to interconnect with interstate systems in order to avoid becoming subject to the full panoply of Federal Power Act regulation.[11] In Section 201(b)(2) of the FPA, Congress specified that while these otherwise nonjurisdictional entities "shall be subject to the jurisdiction of the Commission for purposes of carrying out" orders under the new interconnection and wheeling authority, compliance with such orders would not make such entities subject to the Commission's jurisdiction for any other purposes. 16 U.S.C. (Supp. V) 824(b)(2).

B. The Rules Adopted By The Commission

Following extensive rulemaking proceedings,[12] the Commission issued Order No. 69 (Pet. App. B-38 to B-119), governing transactions between utilities and qualifying facilities. That order embodies a number of regulations designed to accomplish the statutory goal of encouraging the development of cogeneration and small power production. Two of those regulations are at issue here.[13]

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[11] See, e.g., 124 Cong. Rec. 34770 (1978) (remarks of Sen. Bartlett); 123 Cong. Rec. 32397-32398 (1977) (colloquy between Sen. Domenici and Sen. Johnston).

[12] In June, 1979, the Commission issued a staff discussion paper addressing issues arising under Section 210 of PURPA. J.A. 6-35. In addition to receiving written comments on the paper, the Commission's staff held public hearings in San Francisco, Chicago and Washington, D.C. In October 1979, the Commission issued a Notice of Proposed Rulemaking on Section 210 of PURPA. J.A. 36-89. Additional comments were received and public hearings were held in Seattle, New York City, Denver and Washington, D.C. A final draft rule was made available on January 29, 1980, and representatives of electric utilities and public utility commissioners were invited to comment at public meetings held in February, 1980. See Pet. App. B-40 to B-41.

[13] In Order No. 70 (Pet. App. B-120 to B-174), the Commission established criteria for determining when a cogeneration or small power production facility shall be considered a qualifying facility

1. The first regulation provides that the rate for a purchase of electricity by a utility from a new qualifying facility must be equal to the utility's full "avoided costs." 18 C.F.R. 292.304(b)(2). The term "avoided costs" is defined in 18 C.F.R. 292.101(b)(6) as the equivalent of the statutory term "incremental cost of alternative electric energy." See note 4, *supra*.

The Commission noted that "under the full avoided cost standard, the utilities' customers are kept whole, and pay the same rates as they would have paid had the utility not purchased energy and capacity from the qualifying facility" (Pet. App. B-65). In addition, the Commission made the following observations (*ibid.*):

> Although use of the full avoided cost standard will not produce any rate savings to the utility's customers, several commenters stated that these ratepayers and the nation as a whole will benefit from the decreased reliance on scarce fossil fuels, such as oil and gas, and the more efficient use of energy.
>
> The Commission notes that, in most instances, if part of the savings from cogeneration and small power production were allocated among the utilities' ratepayers, any rate reduction will be insignificant for any individual customer. On the other hand, if these savings are allocated to the relatively small class of qualifying cogenerators and small power producers, they may provide a significant incentive for a higher growth rate of these technologies.

The Commission considered, but rejected, a fixed-percentage-of-avoided-cost-rule, finding that such a rule would cause a qualifying facility to cease production of energy if its costs exceeded that fixed percentage price (Pet. App. B-66). The Commission explained that "[i]f this occurs, the utility will be forced to operate generating units which either are less efficient than those which would have been used by the qualifying facility, or which

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within the meaning of PURPA. The regulations adopted in Order No. 70 were upheld by the court of appeals below and are not at issue here.

consume fossil fuel rather than the alternative fuel which would have been consumed by the qualifying facility had the price been set at full avoided costs" (*ibid.*).

2. The second regulation at issue, codified at 18 C.F.R. 292.303, requires electric utilities to: (1) purchase any energy and capacity made available from a qualifying facility; (2) sell energy and capacity to any qualifying facility at the latter's request; and (3) make the interconnections necessary to accomplish such transactions at the qualifying facility's expense.[14] As the Commission recognized, Section 210(a) of PURPA expressly refers only to purchases and sales and not to interconnections. The Commission concluded, however, that Congress' directive that the Commission "prescribe * * * such rules as it determines necessary to encourage cogeneration and small power production" (16 U.S.C. (Supp. V) 824a-3(a)) provides clear authority for the Commission to require the interconnections necessary to accomplish the expressly mandated purchases and sales (Pet. App. B-58 to B-59).

The Commission rejected the argument that under Section 210(e)(3)(B) of PURPA it must afford an evidentiary hearing and "require that qualifying facilities go through the complex procedures [required by Sections 210 and 212 of the Power Act] simply to gain interconnection" for the purpose of effectuating the transactions mandated by Section 210(a) of PURPA (Pet. App. B-59 to B-60). The Commission reasoned that the language of Section 210(a) of PURPA "provides a general mandate for the Commission to prescribe rules necessary to encourage cogeneration and small power production [and thus provides] sufficient authority to require interconnection" (Pet. App. B-60). On the other hand, the Commission determined, to require qualifying facilities to utilize FPA Sections 210 and 212 as the means of obtaining interconnection would "significantly frustrate" achievement of the purpose of Section 210(a) of PURPA, viz., to pro-

[14] The requirement that the qualifying facility bear the expense of making the interconnection is codified at 18 C.F.R. 292.306.

vide a market for the electricity generated by cogenerators and small power producers (Pet. App. B-60).

On rehearing, the Commission adhered to these determinations (Pet. App. B-179 to B-182). It recognized that the "primary question" with regard to the interconnection issue is the proper interpretation of Section 210(e) of PURPA, which empowers the Commission generally to exempt qualifying facilities from regulation as public utilities under the Power Act except—by virtue of subsection (e)(3)(B)—from the authority newly granted in Sections 210 and 212 of the Power Act (Pet. App. B-180). In the Commission's opinion, subsection (e)(3)(B) has no application to Section 210(a) of PURPA, but rather evinces Congress' intent to "impose [certain] obligations on qualifying facilities, including requiring the physical connection of the qualifying facility with the applicant, the sale or exchange [of] electric energy, or an increase in transmission capacity * * *" (Pet. App. B-181). The Commission believed that "[t]o 'exempt' qualifying facilities does not mean to deny them a privilege or right to which they would otherwise be entitled [i.e., to apply for an interconnection order under FPA Section 210]"; rather "it is from these obligations [of FPA Sections 210 and 212 making qualifying facilities subject to an interconnection order] that section 210(e)(3)(B) provides that qualifying facilities may not be exempted" (Pet. App. B-181).

C. The Decision Of The Court Of Appeals

The court of appeals vacated the Commission's rules as to full avoided cost and interconnection (Pet. App. B-1 to B-34).

1. In striking down the "full avoided cost" rule, the court viewed the critical issue as whether the rule "is consistent with the statutory mandate that the rates set by the Commission must, in addition to not discriminating against cogenerators, also be 'just and reasonable to the electric consumer of the electric utility' and 'in the

public interest' " (Pet. App. B-9). The court held that the Commission had not adequately established that the full avoided cost rule met these statutory requirements (*ibid.*).

First, the court determined that the Commission "without convincing explanation had simply adopted as a uniform rule the maximum purchase rate specified in the statute" (Pet. App. B-10). The Commission had failed, in the court's view, to meet the "minimum" requirement that it "make clear and explain how the rates it sets are consistent with the statutory criteria" (*ibid.*). The court believed that the Commission had not "demonstrate[d] the factual basis" for its determination that something less than full avoided cost would result in " 'insignificant' " rate reductions for utility customers (*id.* at B-11). Second, the court upheld the Commission's rejection of a split-the-savings [15] rule on the ground that such a rule "would require utilities-type regulation in contravention of the purpose of PURPA," but the court noted that there are other alternatives that the Commission could have adopted instead of full avoided cost that also might avoid the traditional utilities-style ratemaking that Congress sought to prevent (*ibid.*). Finally, the court asserted that the Commission's determination "that the bare, unquantified possibility that a rule permitting rates at less than full cost *might* be insufficient to encourage the last kilowatt hour of cogeneration" is "inconsistent with the clear intent of section 210(b), which seeks to strike a balance among the interests of cogenerators, 'electric consumers of electric utilit[ies]' and the 'public interest' " (*id.* at B-12; emphasis in original). The court directed that on remand the Commission "should allocate the benefits more evenly between the cogenerators and the utilities if the utilities can demonstrate that, under a percentage of avoided cost

[15] As the court explained, under a "split-the-savings" approach, "the price is set somewhere between the incremental cost of the buying utility and the incremental cost of the selling utility, so that each benefits by the transaction" (Pet. App. B-13 n.37).

approach, an allocation less heavily favoring the cogenerators is in the public interest of the utilities' electric consumers, and will not disproportionately discourage cogeneration" (*ibid.*).

2. The court below also invalidated the rule authorizing interconnections between qualifying facilities and utilities. In its view, since Section 210(e)(3)(B) of PURPA prohibits the Commission from exempting qualifying facilities from Sections 210, 211 and 212 of the Federal Power Act, the Commission must afford evidentiary hearings and make findings under these provisions before ordering any interconnections it deems necessary to accomplish the purchases and sales required under Section 210(a) of PURPA (Pet. App. B-20 to B-25). The court interpreted the Commission's interconnection rule as effectively exempting qualifying facilities from these Power Act procedures, a result that the court believed was inconsistent with the statutory requirements.

The court characterized the Commission's interpretation of Section 210(e)(3)(B) of PURPA "as protecting cogenerators who are *targets* of *other* parties seeking interconnection, and not extended to situations where the cogenerator is an *applicant* for an interconnection itself" (Pet. App. B-24; emphasis in original). While the court agreed that this was "an interesting and not inherently implausible suggestion," it believed that this interpretation was not supported by the language or legislative history of the statute (*id.* at B-25). Finally, the court expressed the view that any undue burden its interpretation placed on qualifying facilities could be avoided by adopting "streamlined procedures," but that, if even those were too burdensome, "the necessary amendment must come from Congress" (*id.* at B-23).

3. The Commission's petition for rehearing was denied by the panel (Pet. App. B-202 to B-204). A majority of the whole court did not participate in considering the suggestion for rehearing en banc and that suggestion also was denied (Pet. App. B-205 to B-208). The only

two judges (apart from the panel members) to consider the suggestion voted to rehear the case en banc "because of the importance of the issues to major new energy programs of cogeneration and small power production and because of serious doubts over the panel's resolution of those issues" (*id.* at B-206).

As to the full avoided cost issue, the dissenters expressed the view that the Commission appears to have acted reasonably in weighing the statutory interests and adopting "a rate that would encourage cogeneration without raising rates to consumers" (Pet. App. B-207), and that the panel erroneously had employed the more stringent "substantial evidence" test rather than the applicable "arbitrary and capricious" standard of review (*id.* at B-207 & n.2).

As to interconnection, the dissenters noted that "[t]he panel has interpreted an incredibly complex and ambiguous interlace of statutory sections to require a full-scale evidentiary hearing prior to any interconnections for the sale or purchase of cogenerated power" (Pet. App. B-207 to B-208). In the dissenters' view, the Commission's interpretation, which the panel rejected, "is a plausible one and appears to be more closely in line with Congress' expressed desire to encourage cogeneration" (*id.* at B-208).

SUMMARY OF ARGUMENT

Pursuant to Section 210(a) of PURPA, the Commission promulgated a series of rules designed to effectuate the congressional directive "to encourage cogeneration and small power production." The court of appeals vacated two of these rules: (1) the rule establishing the rate for purchases of cogeneration-produced power at the utility's full avoided cost; and (2) the rule requiring utilities to interconnect with cogenerators in order to facilitate the purchases of cogeneration-produced power that were mandated by Congress in PURPA Section 210. The court's decision as to both rules is based on a

serious misunderstanding of the statutory and regulatory scheme. Unless overturned, the decision below will substantially thwart the congressional purpose of reducing the nation's reliance on imported oil by encouraging the development of nontraditional energy sources.

I

A. Contrary to the apparent assumption of the court of appeals, Congress clearly contemplated that a full avoided cost rate would be within a "zone of reasonableness," albeit at the upper end of that zone. Although Section 210(b) of PURPA, 16 U.S.C. (Supp. V) 824a-3(b), states that rates for purchases by a utility of cogeneration-produced electricity are to be just and reasonable to the utility's customers and in the public interest, the statute also expressly authorizes the Commission to set rates at a level not to exceed full avoided (or incremental) cost. Thus, a full avoided cost rate is consistent with the literal terms of the statute. Moreover, in holding that the Commission is required under the just and reasonable standard to pass along the benefits of lower costs to the utility's customers, the court below has disregarded the basic statutory mandate, which is to "encourage" cogeneration, not to avoid "disproportionately discourag[ing] cogeneration" (Pet. App. B-12).

B. In addition, the court misapprehended the thrust of the Commission's full avoided cost rule. The rule does not *require* a full avoided cost rate for the purchase of cogeneration-produced power; the rule simply sets the context for bargaining between the utility and the cogenerator. Parties are free to negotiate a contract for purchases at a lower rate. Moreover, the state regulatory commission can seek a waiver of the rule if it shows that a full avoided cost rate is not necessary to encourage cogeneration.

Furthermore, the decision below is grounded on the mistaken premise that the Commission had failed to determine that utilities possess monopsony power. But both Congress and the Commission have stated that a primary

reason for enactment of Section 210 of PURPA was the monopsony power of electric utilities, manifested by their refusal to purchase cogeneration-produced electricity at all, or their unwillingness to pay an appropriate rate for such power.

The court of appeals expressed the belief that rates to consumers would be increased under a full avoided cost standard. This belief is based on an erroneous understanding of the manner in which costs would be allocated to customers under a full avoided cost rule. By definition, full avoided (or incremental) cost is no higher than the cost to the utility of generating electricity itself or purchasing electricity from another source.

C. The court of appeals applied an erroneous standard of review. In vacating the full avoided cost rule, the court appears to have applied the "substantial evidence" test, a standard that not only is incompatible with review of informal agency action generally, but is especially unsuited to reviewing a rule such as the full avoided cost rule, which was adopted as a predictive judgment based on agency expertise regarding the rate level necessary to encourage future cogeneration and small power production. The court's conclusion that it would not uphold the Commission's determination to promulgate the full avoided cost rule unless the rule is supported by specific factual findings represents the same type of judicial interference with agency decisionmaking that this Court condemned in *Vermont Yankee Nuclear Power Corp.* v. *Natural Resources Defense Council, Inc.*, 435 U.S. 519, 547-548 (1978).

II

In empowering the Commission under Sections 210, 211 and 212 of the Federal Power Act to require greater coordination of the nation's electric transmission facilities, Congress dealt with an entirely different problem than the concern addressed in Section 210 of PURPA, which was enacted to remove the impediments to the development of cogeneration and small power production.

The language and history of the Power Act provisions demonstrate that Congress sought to assure that the Commission could require any entity that sells electricity to coordinate its transmission operations with other such entities. Congress hoped that by exercising this power, the Commission could avoid construction by utilities of expensive excess transmission and generating capacity, while at the same time enhancing the reliability of all systems.

On the other hand, in Section 210 of PURPA, Congress sought to remove the barriers that had impeded development of energy-efficient alternative sources of electric power. Thus, Congress required utilities to provide a market for power generated by cogenerators and small power producers and to sell back-up power to them; and Congress provided that these alternative sources of electricity may be exempted from state and federal regulation as public utilities.

At the same time, however, Congress sought to insure that the Commission's broad new Power Act authority to order interconnection would apply to all nonjurisdictional entities, including cogenerators and small power production facilities. Accordingly, in Section 210(e)(3)(B) of PURPA, 16 U.S.C. (Supp. V) 824a-3(e)(3)(B), Congress expressly precluded the Commission from exempting qualifying facilities from that Power Act authority.

Instead of viewing this limitation in light of the distinct congressional purposes underlying the amendments to the Power Act and the provisions of Section 210 of PURPA, the court below erroneously concluded that, under Section 210(e)(3)(B) of PURPA, cogenerators and small power producers must use the Power Act procedures—which require evidentiary hearings and specific public interest findings—each time they wish to interconnect with a reluctant public utility in order to effectuate a purchase and sale mandated under Section 210(a) of PURPA. This interpretation is not only contrary to a common sense reading of the statutory language, but it

also would effectively reimpose the barriers to cogeneration and small power production that Congress sought to remove in enacting Section 210 of PURPA.

ARGUMENT

I. IN VACATING THE COMMISSION'S FULL AVOIDED COST RULE THE COURT OF APPEALS MISCONSTRUED THE UNDERLYING STATUTE, MISPERCEIVED THE NATURE AND EFFECT OF THE RULE, AND APPLIED AN ERRONEOUS STANDARD OF JUDICIAL REVIEW

Throughout its opinion, the court of appeals evinced a strong hostility to the full avoided cost rule adopted by the Commission.[16] This antagonism appears to have influenced the court's ultimate conclusion that the rule did not satisfy the statutory standards. Even more directly, the court's apparent distaste for the rule seems to have triggered its decision to substitute its view of public policy for that of the Commission. The fact is, however, that the court below seriously misunderstood the nature and effect of the rule. Accordingly, as we proceed to identify the court's legal errors we also will document its factual misperceptions in order to demonstrate that the court's misgivings as to a full avoided cost rate are unfounded.

A. The Full Avoided Cost Rule Satisfies The Relevant Statutory Criteria

Following a lengthy rulemaking proceeding conducted pursuant to Section 210 of PURPA, the Commission determined that purchases of electricity by a utility from a new qualifying facility must be at a rate equal to

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[16] E.g., "[T]he Commission came to the simplistic and uniform conclusion that the full avoided cost standard would be just and reasonable in every case and that this was necessary to encourage cogeneration in every case" (Pet. App. B-9); the adoption of the rule "without convincing explanation" avoids "the hard questions * * * *" (*id.* at B-10); the rule is not the product of "reasoned consideration * * * *" (*id.* at B-12).

the utility's full "avoided costs" (18 C.F.R. 292.304 (b)(2)), and it defined "avoided costs" as the equivalent of the statutory term "incremental cost of alternative electric energy." 18 C.F.R. 292.101(b)(6). Although the basis articulated by the court for vacating this rule was that the "[Commission] did not justify and explain its decision to adopt the rule" (Pet. App. B-34), a careful reading of the court's opinion indicates that the court also viewed the full avoided cost rule as inconsistent with the requirements of the statute.[17]

Under the court's analysis (see Pet. App. B-10 to B-12), the rule fails to take account of the "just and reasonable" and "in the public interest" criteria of Section 210(b) of PURPA. This analysis appears to rest on the assumption that under the statutory "just and reasonable" standard, the upper end of the "zone of reasonableness"—the area within which the Commission has the discretion

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[17] Inded, the court stated at one point that the Commission's rejection of a rule that would have established rates at less than 100% of avoided costs "seems entirely inconsistent with the clear intent of section 210(b)" (Pet. App. B-12). Respondents appear to agree with this assessment (see Br. in Opp. 9, 10, 18).

To be sure, in its opinion denying rehearing, the court stated (Pet. App. B-203) that it had not declared the Commission's rule to be inconsistent with the statute. But the court's hostility to the full avoided cost rule appears to rest, at least in part, on the notion that the Commission lacks authority to adopt such a rule, whatever justifying reasons it might proffer.

This Court previously has had occasion to pierce the literal language of a court of appeals' opinion to find the actual basis for the lower court's decision. In *Vermont Yankee Nuclear Power Corp.* v. *Natural Resources Defense Council, Inc.*, 435 U.S. 519, 541-542 (1978), this Court found that, despite the fact that the lower court "refrained from actually ordering the agency to follow any specific procedures, * * * there is little doubt in our minds that the ineluctable mandate of the court's decision is that the procedures afforded during the hearings were inadequate." After concluding that the procedures employed by the agency satisfied legal requirements, this Court reversed the lower court's decision. *Id.* at 542-548.

to select a rate—falls somewhere below the level of full avoided cost. This assumption is based on a statement in the legislative history indicating that the lower of a "just and reasonable" and a full avoided cost rate was to apply.[18] The ultimate logic of this position appears to be that the rates to the electric consumers of a utility can never be considered "just and reasonable" unless such consumers are allowed to share directly in the short term benefits of the new program by virtue of a reduction in their rates. It is our submission that this view misconceives the statutory framework and fails to give adequate consideration to the findings of the Commission.

1. The statute expressly authorizes the Commission to adopt a rule based on full avoided cost. Section 210(b) of PURPA states that "[no] rule [establishing a rate for purchases] shall provide for a rate which exceeds the incremental cost to the electric utility of alternative electric energy." Incremental cost means full avoided cost.[19] At the same time, the Commission is required to establish a rate that is "just and reasonable to the electric consumers of the electric utility and in the public interest * * *." 16 U.S.C. (Supp. V) 824a-3(b)(1).[20] Although Congress did not specifically es-

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[18] See Pet. App. B-9 to B-10, quoting H.R. Conf. Rep. No. 95-1750, 95th Cong., 2d Sess. 98 (1978).

[19] The court of appeals recognized that the full avoided cost standard utilized by the Commission is identical to the statutory concept of "incremental cost * * * of alternative energy." See Pet. App. B-8 n.28.

[20] The terms "in the public interest" and "just and reasonable" are interchangeable terms in the public utility ratemaking context. See, e.g., *United Gas Pipe Line Co.* v. *Mobile Gas Service Corp.*, 350 U.S. 332, 345 (1956); *FPC* v. *Sierra Pacific Power Co.*, 350 U.S. 348, 355 (1956). In both cases this Court concluded that a Commission finding that a rate is so low as to adversely affect the public interest is sufficient to satisfy identical provisions of the Natural Gas Act and the Federal Power Act requiring a Commission finding that a rate is "unjust" or "unreasonable" before the

tablish a "zone of reasonableness" for the Commission in mandating a just and reasonable rate for purchases, it expressly declared, in Section 210(b) of PURPA, that the rate may not exceed incremental (or full avoided) cost. Thus, Congress clearly contemplated that a full avoided cost rate would be within that zone, albeit at the upper end. See H.R. Conf. Rep. No. 95-1750, 95th Cong., 2d Sess. 98 (1978).

It is settled that "courts are without authority to set aside any rate selected by the Commission which is within a 'zone of reasonableness.'" *Permian Basin Area Rate Cases*, 390 U.S. 747, 767 (1968), quoting *FPC* v. *Natural Gas Pipeline Co.*, 315 U.S. 575, 585 (1942). Indeed, it is firm doctrine that the "Commission may, within this zone, employ price functionally in order to achieve relevant regulatory purposes; it may, in particular, take fully into account the probable consequences of a given price level for future programs of exploration and production." *Mobil Oil Corp.* v. *FPC*, 417 U.S. 283, 317 (1974), quoting *Permian Basin*, *supra*, 390 U.S. at 796-798. The Commission's full avoided cost rule, by not exceeding the upper limit set by Congress, clearly falls within the zone of reasonableness. Thus, the court of appeals erred in setting the rule aside on the belief that Congress required the Commission to set the rate for purchases at a level below incremental cost.

2. The court's erroneous view of the statutory standard is underscored by its misapprehension of the showing that would be necessary to support adoption of a full avoided cost rule. In the court's opinion, the statute requires an immediate "share of the benefits" to the utilities' customers so long as that would not "*disproportionately dis-*

Commission may fix a new rate. By the same token, the terms "public interest" and "just and reasonable to the electric consumers" in Section 210(b)(1) of PURPA surely enlarge the Commission's regulatory focus beyond the narrow question whether a particular rate for purchases of electricity from qualifying facilities will actually result in lower rates to consumers.

courage cogeneration" (Pet. App. B-12; emphasis added). That, however, is not the statutory standard. As the Commission recognized, the central aim of Congress in Section 210 of PURPA was to *encourage* cogeneration through a program that serves the interest of the public and of the utilities' customers.

While the Commission recognized that "the full avoided cost standard will not produce any rate savings to the utility's customers" (Pet. App. B-65), it did not view this as the dispositive consideration. On the contrary, the Commission concluded that "these ratepayers and the nation as a whole will benefit from the decreased reliance on scarce fossil fuels, such as oil and gas, and the more efficient use of energy" (*ibid.*).[21] Under this approach, the utilities' customers are "kept whole" while "a significant incentive [is provided] for a higher growth rate of [cogeneration and small power production] technologies" (*ibid.*).

3. The court of appeals' rejection of the Commission's considered interpretation of the statute represents a marked departure from traditional standards governing judicial review of an agency's construction of the statute it administers. As this Court has made clear, "in determining whether the Commission's action was 'contrary to law,' the task for the Court of Appeals was not to interpret the statute as it thought best but rather the narrower inquiry into whether the Commission's construction was 'sufficiently reasonable' to be accepted by a reviewing court." *FEC* v. *Democratic Senatorial Campaign Committee*, 454 U.S. 27, 39 (1981). Respect for the agency's view is particularly appropriate "when the administrative practice at stake involves a contemporaneous construction of a statute by the men charged with the responsibility of setting its machinery in motion,

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[21] As we have observed (see note 20, *supra*), the inquiry under the statute does not focus on the consumers' interests in isolation, but rather examines their concerns in the context of the broader "public interest."

of making the parts work efficiently and smoothly while they are yet untried and new." *Udall* v. *Tallman*, 380 U.S. 1, 16 (1965), quoting *Power Reactor Development Co.* v. *International Union of Electrical, Radio & Machine Workers*, 367 U.S. 396, 408 (1961). See *Zenith Radio Corp.* v. *United States*, 437 U.S. 443, 450 (1978). The court below failed to follow these precepts in this case. Moreover, as we now show, the court compounded this error by substituting its judgment for that of the Commission, contrary to the well established principle that courts " 'should not overrule an administrative decision merely because they disagree with its wisdom.' " *CBS, Inc.* v. *FCC*, 453 U.S. 367, 394 (1981), quoting *Radio Corp. of America* v. *United States*, 341 U.S. 412, 420 (1951).

B. The Court Of Appeals' Detailed (And Erroneous) Evaluation Of The Full Avoided Cost Rule Reflects Its Improper Intrusion Into The Domain Reserved To The Administrative Agency

We have already suggested that the court of appeals' erroneous view of the statute was bottomed in large part upon its failure to understand the Commission's full avoided cost rule. Even more seriously, the court's misapprehension of, and manifest hostility to, the rule colored the scope of its review of the Commission's decision. After first focusing on the court's errors with regard to the nature and effect of the full avoided cost rule, we will demonstrate that the court erred in substituting its own views for those of the Commission and in applying an erroneous standard of review.

1. *The Full Avoided Cost Rule does not automatically require that the actual rate paid by a utility to a qualifying facility be fixed at full avoided cost*

The court below incorrectly assumed that utilities would always have to pay a full avoided cost rate to qualifying facilities. Thus, the court stated, "[b]ut for

FERC's regulations, the utility may have paid a cogenerator a market purchase rate of something less than the full avoided cost, under a standard industry practice" (Pet. App. B-13; footnote omitted). Elsewhere the court remarked that "the Commission came to the simplistic and uniform conclusion that the full avoided cost standard would be just and reasonable in every case and that this was necessary to encourage cogeneration in every case" (*id.* at B-9). The court's assumption is entirely unfounded.

To begin with, although Section 210(f) of PURPA requires the states to "implement" the Commission's rules, any state regulatory authority and any nonregulated electric utility may apply to the Commission for a waiver of its rules. Waivers may be granted where a full avoided cost rate is demonstrated to be unnecessary to encourage cogeneration or small power production. See 18 C.F.R. 292.403.[22]

Even more important, however, under the Commission's rules, qualifying facilities and utilities may negotiate contract prices that are lower than a full avoided cost rate. See 18 C.F.R. 292.301(b)(1). Both the utility and the qualifying facility obtain significant advantages from such a negotiated agreement. Many qualifying facilities must secure a long term agreement with a utility in order to obtain institutional financing for a project. Because the Commission's rules do not require a utility to sign a long term contract with a qualifying facility, the utility is in a position to negotiate a price below full avoided cost in return for a long term com-

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[22] Moreover, state regulators and nonregulated utilities are permitted, without seeking a waiver, to set the rate at a level below full avoided cost for purchases from facilities whose construction began prior to the effective date of PURPA if they determine that a lower rate is consistent with the statutory standards and is sufficient to encourage cogeneration and small power production. See 18 C.F.R. 292.304(b)(3).

mitment. In this way the qualifying facility, the utility and the utility's customers all benefit.[23]

Thus, the fundamental error of the court of appeals was its failure to recognize that the very purpose and intended effect of the full avoided cost rule is to avoid the fixing of an unalterable economic relationship. Instead, as the Commission pointed out (Pet. App. B-49), the aim of the rule is to set the context for bargaining between qualifying facilities and utilities. Only in the event that a qualifying facility and a utility fail to reach agreement would the state regulatory authority be required to apply the full avoided cost rule. As this Court recognized in *FERC* v. *Mississippi*, *supra*, slip op. 16, "the statute and the implementing regulations simply require the [state] authorities to adjudicate disputes arising under the statute." See also *id.* at 1-2 n.1 (O'Connor, J., concurring in part in the judgment and dissenting in part). Moreover, as noted above, even where the seller and the purchaser are unable to agree on a rate, the state would be free to petition the Commission for a waiver of the full avoided cost rule.

In enacting Section 210 of PURPA, Congress recognized that increased electric energy production by efficient qualifying facilities will replace more expensive and less efficient generation by utilities and help to avoid or defer construction of generating capacity. See *FERC* v. *Mississippi*, *supra*, slip op. 6, 13. Ultimately, this will reduce utility rates and directly benefit consumers and the nation.[24] Furthermore, in promulgating the full avoided cost rate, the Commission reasoned (Pet. App.

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[23] As the Commission explained (Pet. App. B-49), its rules also provide that contracts already in existence prior to the issuance of the rules will not be disturbed, even if they provide for a rate below full avoided cost. See 18 C.F.R. 292.301(b)(2).

[24] See, e.g., L. Johnson & D. Seidman, The Rand Corporation, No. N-1876-DOE, *An Analysis of the Department of Energy's Nonprice Regulation of Industrial Energy Use* 27-39 (May 1, 1982).

B-65 to B-66) that a lower rate undoubtedly would deter some cogeneration and small power production and thus perpetuate the inefficiencies of traditional power production, to the ultimate detriment of the consumer.

In the end, a rate set at full avoided cost simply duplicates the context that would exist in a competitive and unregulated market.[25] Although the court of appeals expressed a strong preference for regulation of prices by the market without governmental interference (Pet. App. B-14 to B-16), the court acknowledged that its discussion regarding marketplace regulation rested on the assumption that utilities "are subject to some competitive restraints" (*id.* at B-16). As we now show, that assumption too was totally unwarranted.

2. *The court of appeals ignored the findings of Congress and the Commission that utilities possess monopsony power*

The court of appeals was of the view that the statutory "command that the interests of consumers and the public be taken into account contemplates consideration of the degree to which market forces may encourage utilities to purchase, and cogenerators to sell, a substantial amount of cogenerated power at a price lower than the statutory limit" (Pet. App. B-14; emphasis omitted). Accordingly, the court's opinion contains a lengthy discussion of the theoretical price of cogenerated power in a competitive market (*id.* at B-14 to B-16). The court explained (*id.* at B-16) that this discussion was relevant because the Commission had failed to determine that utilities possess monopsony power.[26] The court suggested

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[25] In a perfectly competitive market, price is set at or near the level of marginal cost. See 1 A. Kahn, *The Economics of Regulation* 65-67 (1970). Full avoided cost, or incremental cost, approximates marginal cost.

[26] Monopsony power is like monopoly power except that it applies to purchasers in the market rather than to sellers. See *Permian Basin Area Rate Cases*, 390 U.S. 747, 794 n.64 (1968); *Pan-Islamic Trade Corp.* v. *Exxon Corp.*, 632 F.2d 539, 548 n.13 (5th Cir. 1980),

that if the Commission had made such a finding, "then the Commission may have been justified in its present regulation of rates charged by the utilities" (*ibid.*). The fact of the matter is, however, that both Congress and the Commission did make that very finding.

Indeed, while it did not use that precise term, the court of appeals itself acknowledged (Pet. App. B-4) that the monopsony power of electric utilities was a primary reason for enactment of Section 210 of PURPA. Thus, in explaining the "major obstacles" faced by a cogenerator or small power producer prior to PURPA, the court observed that "utilities were often unwilling to purchase the other producers' electric output at all or were unwilling to pay an appropriate rate" (Pet. App. B-4).[27] Similarly, in *FERC* v. *Mississippi*, *supra*, slip op. 6, this Court stated that it was Congress' belief that the development of nontraditional generating facilities (i.e., cogeneration and small power production facilities) was impeded by, inter alia, the reluctance of traditional electric utilities to purchase power from the nontraditional sources.[28]

The court of appeals recognized that Congress designed Section 210 of PURPA "to remove [this] institutional barrier[] to the development of small power production and cogeneration" (Pet. App. B-5). But the court lost sight of the fact that it is precisely the utility's economic ability successfully to refuse to purchase a qualifying facility's output or to pay "an appropriate rate" (*id.* at B-4) that demonstrates its monopsony power.

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cert. denied, 454 U.S. 927 (1981). This market power is generally demonstrated by an ability to control prices and output, or to exclude competitors. See *American Tobacco Co.* v. *United States*, 328 U.S. 781, 811 (1946); *In Re Beef Industry Antitrust Litigation*, 600 F.2d 1148, 1154 n.3 (5th Cir. 1979), cert. denied, 449 U.S. 905 (1980).

[27] The Commission made a similar observation in its order adopting the full avoided cost rule (Pet. App. B-39).

[28] Both this Court, in *FERC* v. *Mississippi*, *supra*, slip op. 6-7 n.12, and the court of appeals in this case (Pet. App. B-4 n.8) cited the legislative history of PURPA in support of this point.

In this context, the court's discussion of the role of free market forces on the price of electricity produced by means of cogeneration is entirely beside the point. For example, the court asserted (Pet. App. B-15 to B-16; emphasis added):

> Cogenerators are in the same position as coal or oil producers—if they are offered a sufficient price by the public utilities and are relieved from burdensome utility-type regulation, they will produce the needed power and sell it to the public utilities. *One reason that these sources have not done so before is that they feared regulation as public utilities.* The law which Congress passed was intended to correct the market distortions caused by government regulations and by the utilities—not to create new ones.

In this discussion, the court failed to focus on the second major reason why cogenerators had not entered the market successfully prior to PURPA—i.e., the refusal of utilities to purchase cogenerated power altogether or the utilities' practice of agreeing to purchase such power only at a very low price, thus preventing cogenerators from competing in the marketplace.[29]

Even assuming the existence of a competitive market for cogeneration-produced power, Congress, in Section 210(a) of PURPA, nonetheless expressly directed the Commission to issue rules "as it determines necessary to encourage cogeneration and small power production." This statutory directive rests in large part on the determination by Congress that "the development of cogeneration and small power production facilities would conserve energy." *FERC* v. *Mississippi*, *supra*, slip op. 13. In light of this congressional finding, it is readily apparent that Congress desired to promote these alternative sources of energy for the reason that their development

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[29] Moreover, the court's statement comparing cogenerators to coal and oil producers is wide of the mark. Unlike cogenerators, coal and oil producers are not constrained to sell their product to a single customer.

would benefit the nation as a whole—including, as the Commission found (Pet. App. B-65), the customers of electric utilities. On the other hand, leaving the price of cogenerated power to the vicissitudes of the current market for electric power, as the court seems to suggest, would contradict Congress' express intent.

3. *The Full Avoided Cost Rule will not result in higher rates to utility customers*

The court of appeals expressed a concern that a full avoided cost rate for cogeneration-produced electricity could result in higher electric rates for the customers of the utility (Pet. App. B-13).[30] This is also incorrect. A qualifying facility selling power to a utility does not "reduce the number of customer-purchased kilowatt hours over which the utility can spread a share of the fixed costs" of extra capacity (*ibid.*), as the court below thought. Such a sale simply replaces capacity and/or energy; it does not affect customer load on the utility's system.

An industrial concern that in the past has purchased power from a utility will continue such purchases even though, as a qualifying facility, it will also be selling power to the utility. Under the simultaneous purchase and sale rule affirmed by the court below (Pet. App. B-16 to B-20), a qualifying facility may sell all of its power at a full avoided cost rate (or at some other rate determined by negotiation) and purchase the power it needs at the utility's retail rate. Under this scheme, a qualifying facility will sell all of the power it produces if the avoided cost rate is higher than the retail rate. Because the qualifying facility in this situation will purchase the same amount of power that it did before, the utility will

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[30] The court's apparent concern is that the production of electricity through cogeneration may reduce customer load on the utility's system. Since the utility's costs will be the same under a full avoided cost rate for purchases from a cogenerator, the utility's customers, according to the court, will end up paying higher rates because the utility's costs will be spread over fewer billing units.

spread its costs to customers over the same number of kilowatt hours and therefore the customer rates will remain the same.

On the other hand, if the utility's retail rate is higher than the full avoided cost rate, the qualifying facility will consume rather than sell the power it produces to avoid paying the higher retail rate. This will reduce the total number of kilowatt hours on a utility's system. But this result cannot be attributed to a full avoided cost for utility purchases. In fact, this result can only occur if the avoided cost rate is too *low*.

As the dissenters from the denial of rehearing en banc pointed out, the Commission selected a rate "that it believed would provide the greatest incentives for cogeneration, as well as the greatest incentives to decrease our national reliance on fossil fuels, *without leading to any increase in rates paid by electric consumers*" (Pet. App. B-206; emphasis added). This conclusion is inescapable, since the Commission's rule sets the rate at full avoided (or incremental) cost which, by definition, is "the cost to the electric utility of the electric energy which, but for the purchase from such cogenerator or small power producer, such utility would generate or purchase from another source." 16 U.S.C. (Supp. V) 824a-3(d).[31]

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[31] The court's other assumptions as to the effect of the full avoided cost rule are also flawed. The court suggested that the Commission in promulgating the rule failed to accommodate the public interest by not considering possible higher pollution effects and lower tax recovery effects from the encouragement of cogeneration (Pet. App. B-12 to B-13).

But the Commission's environmental assessment (45 Fed. Reg. 23661, 23682-23683 (1980)) indicated generally that there would be no significant environmental impacts associated with the development of any PURPA-induced technology at full avoided cost. Moreover, the Commission specifically concluded that employment of these technologies would result in significant net reductions in the use of oil, natural gas and coal. *Id.* at 23683. The single exception involves the Commission's ongoing consideration of the effects of diesel-fueled cogeneration in New York City, on rehear-

C. In Vacating The Full Avoided Cost Rule The Court Of Appeals Applied An Erroneous Standard Of Review

1. This Court has repeatedly stated that rules promulgated after informal rulemaking are subject, not to the "substantial evidence" test, but to an "arbitrary and capricious" standard. See, e.g., *FCC* v. *WNCN Listeners Guild*, 450 U.S. 582, 594 (1981); *FCC* v. *National Citizens Committee for Broadcasting*, 436 U.S. 775, 803 (1978). Yet, in vacating the full avoided cost rule, the court below appears instead to have relied on the rule of *Public Systems* v. *FERC*, 606 F.2d 973 (D.C. Cir. 1979), a case in which the court had applied a "substantial evidence" test on review of an informal rulemaking by the Commission under the Federal Power Act. It is true

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ing of its order qualifying such facilities. Order No. 70-E, 46 Fed. Reg. 33025 (1981).

The court's reference to taxes (Pet. App. B-12) is puzzling. There should be no difference in income tax revenue recovery as a result of the full avoided cost rule, since the utility will continue to supply service to its customers at the same rates as before; the only difference will be that cogenerated power will replace utility-generated power. If the court's reference is to tax benefits made available to qualifying facilities under the Energy Tax Act of 1978, Pub. L. No. 95-618, 92 Stat. 3174 *et seq.*, its argument is wide of the mark. The statutory requirement that the Commission issue rules to encourage technologies that are energy efficient and not dependent on fossil fuels is consistent with Congress' establishment of tax benefits for such enterprises. Congress has determined that the promotion of alternative energy is of greater public benefit than additional tax dollars to the Treasury from traditional energy sources. See Montgomerie, *Federal Income Tax Incentives for the Development and Use of Alternative Energy Sources*, 14 Nat. Resources Law. 339 (1981). The full avoided cost rule merely provides the maximum encouragement contemplated by Congress. Moreover, any tax statute that provides greater benefits for cogenerators than for utilities can be revised at the discretion of the taxing body if that body finds that it would be appropriate to recover greater tax revenues from cogenerators. This would apply to state and local taxes as well as to federal taxes.

that the provision of the Power Act governing judicial review (16 U.S.C. 825*l*(b)) "prescribes a 'substantial evidence' standard for findings of fact in orders." *Public Systems* v. *FERC*, *supra*, 606 F.2d at 979. But, as the dissenters from the denial of rehearing en banc recognized (Pet. App. B-207 n.2), because Section 210 of PURPA—pursuant to which the full avoided cost rule was promulgated—did not amend the Federal Power Act, there was no basis for employing the "substantial evidence" standard of review rather than the more lenient "arbitrary and capricious" standard required by the Administrative Procedure Act, 5 U.S.C. 706(2)(A).[32]

2. Based on its application of the erroneous substantial evidence test, the court of appeals deemed it "especially necessary" that the Commission on remand "demonstrate the factual basis for its conclusion of 'insignificant' savings for [consumers]'" (Pet. App. B-11). But the court did not indicate how the Commission could better support in a rulemaking record any particular percentage of avoided cost other than 100%, or full avoided cost.[33] Presumably, if the Commission instead

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[32] Indeed, it may also be argued that the "substantial evidence" test is not applicable to review of an informal rulemaking proceeding under the Federal Power Act and that, therefore, *Public Systems* was erroneously decided.

[33] The difficulties involved in establishing any particular percentage figure are formidable. The necessary analysis would require consideration of the cost of electric energy and capacity from every sort of cogeneration and small power production technology. These technologies may include steam turbines, combustion turbines, internal combustion engines, solar cells, windmills, and hydro turbines. The fuels used may range from biomass, waste, and geothermal energy in the case of small power production facilities to coal, oil, gas, and nuclear energy for cogenerators. Furthermore, the Commission has received notice of qualifying status for facilities of widely varying capacities, ranging from a single kilowatt to 600 megawatts—a six hundred thousand-fold difference. Even if all production costs could be estimated, the Commission would still have to determine whether a particular rate would be sufficient to

had selected 75% or 85% of avoided cost, it still would be subject to the identical claim that its decision was not factually supported.

The truth is that none of those who filed comments in the rulemaking proceeding made any effort to demonstrate that any particular percentage figure would be sufficient to induce the development of cogeneration and small power production. It apparently was understood by all that the full avoided cost rule was adopted as a predictive judgment based on agency expertise regarding the rate level necessary to encourage future cogeneration and small power production, and that factual justification was neither possible nor required. See, e.g., *FCC* v. *WNCN Listeners Guild, supra*, 450 U.S. at 594-595; *FPC* v. *Transcontinental Gas Pipe Line Co.*, 365 U.S. 1, 28-29 (1961). There is no reason to believe—and, indeed, it is highly unlikely—that a subsequent rulemaking would produce a better record in this regard.[34]

At bottom, the decision below represents the same type of judicial interference with agency rulemaking procedures that this Court condemned in *Vermont Yankee Nuclear Power Corp.* v. *Natural Resources Defense*

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encourage developers whose required rates of return may be markedly different. Cogenerators may be major corporations (engaged in many diverse industrial activities), limited partnerships, owners of commercial properties, non-profit entities such as schools or hospitals, and private individuals. See Br. of Diamond Shamrock, et al., as amici curiae, for a description of various technologies, fuel sources and developers involved in the cogeneration program.

[34] It also should be noted that Congress directed the Commission to promulgate its rules under Section 210 of PURPA within a one-year deadline. As the District of Columbia Circuit itself has recognized, "unless we are quite certain of our basis for doing so, we must be slow to overturn the Agency's judgment, whichever way it may incline, when Congress has required it to act quickly and decisively despite the lack of exact data." *Weyerhaeuser Co.* v. *Costle*, 590 F.2d 1011, 1026 (1978).

Council, Inc., supra, 435 U.S. at 547-548: "If the agency is compelled to support the rule which it ultimately adopts with the type of record produced only after a full adjudicatory hearing, it simply will have no choice but to conduct a full adjudicatory hearing prior to promulgating every rule."

3. Indeed, by directing the Commission on remand to consider a host of "concerns" raised by the full avoided cost rule (Pet. App. B-12 to B-16), the court below has, in essence, substituted its judgment for that of the Commission. For example, the court stated that the Commission "*should allocate the benefits more evenly* between the cogenerators and the utilities if the utilities can demonstrate that, under a percentage of avoided cost approach, an allocation less heavily favoring the cogenerators is in the public interest and the interest of the utilities' electric consumers, and *will not disproportionately discourage* cogeneration" (*id.* at B-12; emphasis added). But Congress left it to the Commission, not the courts, to balance these interests. See, e.g., *Arkansas Louisiana Gas Co.* v. *Hall*, 453 U.S. 571, 577 (1981); *Citizens to Preserve Overton Park, Inc.* v. *Volpe*, 401 U.S. 402, 416 (1971).[35] As the Commission demonstrated (see pages 7-8, *supra*), the full avoided cost rule is the result of a reasonable balancing of these interests. While the court might have preferred a different rule as a matter of policy, the court exceeded its authority by overruling the Commission's judgment on that ground.[36]

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[35] Moreover, as we have already pointed out (see pages 19-20, *supra*), this judicial directive ignores the fact that in Section 210(a) of PURPA, Congress expressly authorized the Commission to issue rules that will "encourage cogeneration," not rules that "will not disproportionately discourage cogeneration."

[36] The court faulted the Commission for failing to consider a flexible rule setting the rate within a range of 80-100% of avoided cost (Pet. App. B-12; see also *id.* at B-203). The court acknowl-

D. The Court Of Appeals' Erroneous Decision To Vacate The Full Avoided Cost Rule Jeopardizes A Significant Federal Program For The Development Of New And Efficient Energy Sources That Is Still In Its Infancy

Unless the decision below is overturned, the substantial benefits that Congress sought to achieve in enacting Section 210 of PURPA—i.e., increasing the efficient use of energy and reducing the nation's reliance on traditional fossil fuels—may never be realized. A majority of the states have complied with the requirements of Section 210 of PURPA by implementing the Commission's full avoided cost rule.[37] If the lower court's decision is

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edged that Congress intended cogenerators to be regulated in a less burdensome manner than traditional utilities (*id.* at B-10), but failed to explain how an 80-100% of avoided cost rule might accomplish this result. In fact, this sort of rule would simply shift the regulatory burden to the states to determine precisely where within the range the rate should be set in any given case. Presumably, each cogenerator would have to develop a utility-type cost of service to determine if a rate exceeding 80% of full avoided cost would be needed to encourage it to produce electricity through cogeneration. This is exactly the sort of utility regulation that Congress sought to avoid. The court itself admitted that "it would probably be an untoward burden and expense to determine permissible rates on a case-by-case basis, or perhaps even a cogeneration method-by-cogeneration method basis. Such a requirement would, in fact, be inconsistent with the overarching congressional intent to streamline rather than impede the implementation of cogeneration" (*id.* at B-16). Yet the court's suggestion of a percentage range rule not only thwarts the intent of Congress, but attempts to impose a policy judgment entrusted by Congress to the Commission. Thus, the court stated at one point (*id.* at B-7 n.26) that "[i]f [respondents] prevail before this Court, the rule will be changed to permit the states to allow the [respondents] to purchase electricity at prices lower than those now required."

[37] Based on information provided to the Commission by the states pursuant to 18 C.F.R. 292.401(c), 39 state commissions have implemented the full avoided cost rule.

permitted to stand, however, the validity of the states' implementing regulations may be jeopardized.

Furthermore, the several years' delay that would result from the initiation of a new rulemaking in a remanded proceeding may cause potential industrial cogenerators to forego the option of building new cogeneration facilities due to the uncertainty of the price that those firms can obtain from sales of cogenerated power. In addition, sources of funds for project financing of qualifying facilities are likely to diminish since the revenue stream from the output of a qualifying facility would no longer be assured. It is also safe to say, if past experience is a reliable guide, that utilities will be unwilling to negotiate contracts with qualifying facilities, or will only offer an unreasonably low price for cogenerated power once the full avoided cost rule—the context for bargaining—is removed.

Finally, we note that Section 210 of PURPA contemplates periodic revisions to the rules concerning cogeneration and small power production. Thus, Section 210(a) states that within one year of PURPA's enactment, "the Commission shall prescribe, *and from time to time thereafter revise*, such rules as it determines necessary to encourage cogeneration and small power production * * *." 16 U.S.C. (Supp. V) 824a-3(a) (emphasis added). After the Section 210 program and the now emergent alternative energy industry are more firmly established, the Commission will have an opportunity to reexamine its full avoided cost rule. With the benefit of experience gained from actual implementation of the full avoided cost rule, the Commission may later find that such a rule is no longer necessary to encourage cogeneration and small power production. The effect of the decision below, however, is to thwart the program at its very inception.

II. THE COMMISSION HAS COMPLETE AUTHORITY UNDER SECTION 210(a) OF PURPA TO REQUIRE UTILITIES TO INTERCONNECT WITH QUALIFYING FACILITIES AS A NECESSARY INCIDENT OF ITS SPECIFIC STATUTORY DUTY TO ENCOURAGE COGENERATION BY THE ADOPTION OF RULES FOR THE PURCHASE AND SALE OF ELECTRIC POWER BETWEEN UTILITIES AND QUALIFYING FACILITIES

The central purpose of Section 210 of PURPA is to encourage production of electricity by qualifying cogeneration and small power production facilities. To that end, Congress, in Section 210(a) of PURPA, directed the Commission to issue rules requiring electric utilities to purchase power from these nontraditional facilities and to provide them back-up power at nondiscriminatory rates. The Commission interpreted Section 210(a) as granting it power to issue a generic rule requiring interconnection in order to implement the statutory mandate of encouraging cogeneration and small power production. The court of appeals' decision vacating the Commission's interconnection rule, like its decision vacating the full avoided cost rule, is based on a serious misperception of the statutory scheme.

Despite the plain fact that interconnection is an integral, indeed essential, condition to the achievement of cogeneration under Section 210(a) of PURPA, the court of appeals nevertheless held that whenever a qualifying facility seeks to interconnect with an unwilling utility in order to engage in cogeneration, it will be required to undergo an evidentiary adjudication to determine if the interconnection is justified under Sections 210 and 212 of the Federal Power Act, 16 U.S.C. (Supp. V) 824i and 824k. The court's conclusion essentially rests on its interpretation of Section 210(e)(3)(B) of PURPA, 16 U.S.C. (Supp. V) 824a-3(e)(3)(B), which provides, inter alia, that the Commission may not exempt qualifying facilities from the Commission's newly granted authority under

Section 210 of the Power Act to compel any cogenerator or small power producer (whether a qualifying facility or not), or any other entity that sells electricity, to interconnect with any electric utility or qualifying facility. As the court viewed it (Pet. App. B-22; emphasis in original):

> By requiring "*any*" utility to make interconnections with "*any*" cogenerator FERC designates, the Commission would in effect exempt qualifying cogenerators from the other procedural and substantive requirements * * * in FPA sections 210 and 212, and deprive utilities of the safeguards afforded by those provisions.

It is our submission that this analysis is seriously flawed because it is based on a misreading of Section 210(e)(3)(B) of PURPA and it puts the statute at cross purposes.

There is no question that in Section 210 of PURPA, Congress enacted legislation to promote cogeneration and small power production. On the other hand, Sections 210, 211 and 212 of the Power Act were enacted to achieve greater coordination and reliability among the nation's electric transmission systems. These different statutory goals address two entirely discrete aspects of efficient use of facilities and resources, and Congress dealt with them separately. The court of appeals' failure to appreciate the distinct purposes of these separate statutes led it to err by superimposing the requirements of the new Power Act provisions onto Section 210 of PURPA.

A. The Power Act Amendments Were Intended To Enhance The Efficiency And Reliability Of Transmission Systems Nationwide; They Have Nothing To Do With PURPA's Separate Goal Of Encouraging Cogeneration

1. Prior to the enactment in 1978 of Section 210 of the Federal Power Act, the Commission's authority to order

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interconnections was limited, under Section 202(b) of that Act, 16 U.S.C. 824a(b), to utilities over which it had regulatory jurisdiction and, except for emergencies, to situations in which a "person engaged in the * * * sale of electric energy" had applied for an order directing a jurisdictional utility to interconnect. The legislative background of FPA Section 210 shows that some intrastate utilities had in the past refused to make interconnections with other systems because, had they done so, they would have become part of an interstate system and thereby subject to the full range of federal regulation under the Federal Power Act. The Commission, under its then-existing authority, was powerless to remedy this problem.

Congress enacted Sections 210, 211 and 212 of the Power Act to grant remedial authority to the Commission to cope with these transmission problems and thereby enhance the reliability of all electric power systems. The new Power Act provisions are thus aimed at improving the coordination of electric transmission operations in order to optimize economic use of the nation's generating capacity while at the same time enhancing reliability. And it is from the requirements that Congress found necessary to achieve these aims—which are entirely distinct from the purchases and sales necessary to promote cogeneration—that the Commission may not exempt qualifying facilities under Section 210(e)(3)(B) of PURPA.

2. This separate statutory goal is plain from the face of the Power Act provisions themselves. Section 210(a)(1) of the Power Act, 16 U.S.C. (Supp. V) 824i(a)(1), empowers the Commission, "[u]pon application of any electric utility, Federal power marketing agency, * * * qualifying cogenerator or qualifying small power producer," to issue an order requiring "the physical connection of any cogeneration facility, any small power production facility, or the transmission facilities of any

electric utility, with the facilities of such applicant." [38] Thus, in Section 210 of the Power Act, Congress was broadly concerned with ensuring the availability of interconnections necessary to coordinate transmission of electricity throughout the nation, not with controlling exchanges of power at the distribution level for cogeneration purposes.[39]

Sections 210(b) and (c) of the Power Act further confirm that the Power Act amendments are wholly unrelated to cogeneration. Those provisions require the Commission, upon receipt of an application for an interconnection order, to issue a notice, to "afford an opportunity for an evidentiary hearing," and, before ordering an interconnection, to make a determination that the interconnection is in the public interest and would conserve energy or capital, optimize efficiency, or improve the re-

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[38] In addition to authorizing the Commission to order interconnections, Congress in FPA Section 210 also empowered the Commission to order "sales" and "exchanges" of electricity. The congressional mandate to the Commission in Section 210(a) of PURPA to require utilities to engage in sales of back-up power to cogenerators would thus be redundant unless Congress, in FPA Section 210, had in mind sales other than those required under PURPA.

[39] Permitting qualifying facilities to apply for such interconnection orders is entirely consistent with Congress' concern with optimizing use of the nation's electric transmission systems. For instance, it is quite conceivable that a qualifying facility might seek to use another cogenerator's or small power producer's lines, rather than build its own lines, to transmit power to a more distant utility. Or a qualifying facility selling electric power at the retail level under the regulation of state authorities might wish to interconnect with a utility or another small power producer to assure an additional supply of power that it could draw upon to serve its customers. In the 1978 amendments to the Power Act, Congress clearly wished to empower the Commission, in these and similar circumstances, to order interconnections that would optimize efficient use of existing facilities.

liability of the affected utility systems. See 16 U.S.C. (Supp. V) 824i(b) and (c).[40] Congress could not possibly have meant for the Commission to make these findings every time a qualifying facility seeks to interconnect with a utility for the purpose of effectuating the purchases and sales mandated by Section 210(a) of PURPA, because in enacting the latter statute Congress itself struck the balance in favor of compelling utilities to purchase electricity from any qualifying facility. See J.A. 17, 47-48.

In short, these new Power Act provisions granted the Commission needed authority to subject nonjurisdictional entities, such as intrastate utilities, municipal utilities and rural cooperatives, to orders directing interconnection and wheeling. At the same time, in Section 201(b)(2) of the Power Act, 16 U.S.C. (Supp. V) 824(b)(2), Congress provided that compliance with such orders would not subject these entities to Commission regulation under any other provision of the Power Act.[41]

3. The legislative history of the Power Act provisions supports our submission that Congress was concerned with enhancing efficiency of transmission services, not with imposing limitations on the cogeneration authority

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[40] See similarly Sections 211(a) and 212(a) of the Power Act, 16 U.S.C. (Supp. V) 824j(a) and 824k(a).

[41] Section 201(b)(2) of the Power Act, 16 U.S.C. (Supp. V) 824(b)(2) (as added by Section 204(b)(2) of PURPA) provides:

> The provisions of sections [210, 211] and [212] * * * shall apply to the entities described in such provisions, and such entities shall be subject to the jurisdiction of the Commission for purposes of carrying out such provisions and for purposes of applying the enforcement authorities of this [Act] with respect to such provisions. Compliance with any order of the Commission under the provisions of section [210] or [211] * * * shall not make an electric utility or other entity subject to the jurisdiction of the Commission for any purposes other than the purposes specified in the preceding sentence.

fully provided for in Section 210 of PURPA. As Senator Metzenbaum stated, in explaining the purpose of the Power Act amendments (124 Cong. Rec. 34763-34764 (1978))[42]:

> Individual electric utility systems need to have adequate reserves in the event some of its [sic] generating facilities or transmission lines become inoperable. Unfortunately, to provide for such situations, many utilities have overbuilt. They have made large capital investments in generating facilities which stand idle most of the time. And which add considerably to consumer costs.
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> A better solution would have been * * * [to] create a national grid * * * to provide a reliable national network of transmission facilities so that when one area is power short, energy could be moved across transmission lines to prevent blackouts like we have seen in New York and New England in recent years * * *. The bill pending before us would certainly not create a national grid. However, it would grant to FERC some authority so that we could prevent wasteful overconstruction of new generating and transmission facilities and make better use of existing facilities.

Although many utility systems are interconnected voluntarily, Congress found it necessary to adopt these new Power Act provisions because some utilities, operating entirely intrastate and therefore beyond the Commission's existing Power Act jurisdiction, had refused to interconnect across the state line in order to avoid becoming subject to the full panoply of Federal Power Act regulation. Senator Bartlett specifically addressed this problem in his

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[42] See also 124 Cong. Rec. 38369 (1978) (remarks of Rep. Dingell introducing the Conference Report on the floor of the House).

discussion of the legislation (124 Cong. Rec. 34770 (1978))[43]:

> The history of these provisions [Sections 210, 211 and 212 of the Power Act], in both the House Committee on Interstate and Foreign Commerce and the Senate Committee on Energy and Natural Resources, shows that one of the problems these provisions are designed to meet is the apparent lack of an appropriate forum in which to resolve the so-called Texas problem. The Electric Reliability Council of Texas, know [sic] as ERCOT, contains the major portion of the electric utilities in Texas and has apparently operated in electrical isolation from the rest of the United States for a number of years * * *.
>
> A number of public utilities operating both within and outside the State of Texas have sought to achieve electrical interconnection between ERCOT and the Southwest power pool, but they have been strongly opposed by several of the major utilities in ERCOT. * * * Whatever the merits of this controversy may be, practically everyone who has seriously addressed the question agrees that there should be full authority in the Federal Energy Regulatory Commission, either on its own motion or on the motion of any of the utilities involved, to hold hearings and decide whether it is in the national interest that the isolation of ERCOT be terminated by any adequate system of interconnection and the necessary coordination to accompany it, or whether the status quo should be maintained.

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[43] See 123 Cong. Rec. 31194 (1977) (remarks of Sen. Johnston); *id.* at 32397-32398 (colloquy between Sen. Domenici and Sen. Johnston); *id.* at 32398-32399 (colloquy between Sen. Bartlett and Sen. Johnston). See also *Public Utility Rate Proposals of President Carter's Energy Program: Hearing on S.122, S.1300, S.1368, S.1364, S.1469 (Part E) Before the Subcomm. on Energy Conservation and Regulation of the Senate Comm. on Energy and Natural Resources*, 95th Cong., 1st Sess., Pt. 3 (1977).

B. Section 210(a) Of PURPA Grants The Commission Complete Authority To Order The Interconnections Necessary To Effectuate The Purchases And Sales Essential To Effectuate A Meaningful Cogeneration Program

1. In Section 210(a) of PURPA, 16 U.S.C. (Supp. V) 824a-3(a), Congress imposed on the Commission the duty to "prescribe * * * such rules as it determines necessary to encourage cogeneration and small power production," including rules requiring utilities to purchase power from and sell power to qualifying facilities. Because physical interconnections are absolutely essential to the consummation of such transactions, the authority to require by rule purchases and sales must necessarily include the power to mandate the necessary interconnections. Thus, a straightforward reading of the express language of Section 210(a) of PURPA fully supports the Commission's view that that provision grants "sufficient authority to require interconnection" (Pet. App. B-60).

This interpretation is confirmed by an examination of Section 210 of PURPA in its entirety, which reveals that Congress intended that statute to constitute a complete and self-contained authority to insure the incorporation of cogeneration and small power production into the electric industry. Thus, Section 210(a) requires utilities to provide a market for electricity generated by such facilities that qualify under the Commission's rules for benefits under PURPA and to provide back-up power for such facilities. Sections 210(b), (c) and (d) assure that the rates at which utilities purchase electricity from and sell back-up power to qualifying facilities are neither discriminatory toward qualifying facilities nor unreasonable to the utilities' customers, and that cogeneration and small power production will not be subsidized by electric utility customers but rather will gain a share of the market only when they are economically competitive

with alternative sources of power. Section 210(e) removes the regulatory impediments to cogeneration and small power production by allowing the Commission to exempt qualifying facilities from state and federal regulation as public utilities. Section 210(f) provides for implementation of the Commission's rules at the state level, and Sections 210(g) and (h) concern enforcement of federal and state rules and judicial review of federal and state action under Section 210.

To conclude, as did the court of appeals, that Congress intended to omit from this comprehensive mandate the very authority that is absolutely essential to make the program work—i.e., the authority of the Commission to direct utilities to hook-up with qualifying facilities—"would be to impute to Congress a purpose to paralyze with one hand what it sought to promote with the other." *Clark* v. *Uebersee Finanz-Korporation, A.G.*, 332 U.S. 480, 489 (1947).

2. The legislative history of Section 210 of PURPA supports the Commission's interpretation. Neither the House nor the Senate version of the legislation that went to conference contained any special procedural prerequisites for interconnections between qualifying facilities and utilities. The Senate bill contained a general mandate to the Secretary of Energy (not the Commission) to recommend "guidelines" to state regulatory commissions that would have required electric utilities to purchase electricity from and sell electricity to qualifying cogenerators and small power producers. S. 2114, Section 12, 95th Cong., 1st Sess. (1977). The House bill, on the other hand, contained a provision that would have directed the Commission to prescribe "rules respecting the interconnection of a qualifying cogeneration facility to the distribution system of any electric utility or to a centrally dispatched power pool * * *." H.R. 8444, Section 546(a)(2), 95th Cong., 1st Sess. (1977). In addition, Section 546(a) of the House bill would have required the Commission to issue rules for allocating costs of a qualifying facility;

rules relating to minimum reliability standards for a qualifying facility; rules regarding the responsibility of an owner or operator of a qualifying facility during a period of electric shortage; and rules specifying the reliability of emergency electric service available to a qualifying facility.[44]

In enacting PURPA, Congress essentially adopted the House version, but it deleted the enumeration of rules relating to interconnection, allocation of costs, reliability and other similar factors. It therefore is reasonable to conclude that Congress viewed the obligation to interconnect as subsumed within the obligation to purchase and sell, which was retained in the legislation as part of Section 210(a) of PURPA.[45]

3. Despite this strong evidence of congressional intent, the court of appeals rejected the Commission's view because in Section 210(e)(3)(B) of PURPA Congress stated that qualifying facilities are not exempt from "the provisions of section 210, 211 or 212 of the Federal Power Act * * *." Viewing this language in isolation, the court below reached the erroneous conclusion that unless this limitation was meant to apply in the context

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[44] It is worth noting that the House version's specific mention of interconnection rules was not written in terms authorizing the Commission to *require* interconnection, or establishing procedural requirements as a precondition for interconnection; the necessity for interconnections appears to have been assumed. By proposing to empower the Commission to include "rules *respecting*" interconnection, along with other rules respecting allocation of costs, reliability, etc., the House was simply anticipating some of the factors involved in establishing the new program of mandating utilities to transact with qualifying facilities.

[45] That Congress assumed utilities and qualifying facilities would be required to interconnect to carry out the mandate of Section 210 is also supported by the Conference Report, which indicates that in setting rates at which utilities sell back-up power to qualifying facilities, the Commission is to disallow "unreasonable hook-up charges." H.R. Conf. Rep. No. 95-1750, *supra*, at 98. See J.A. 18.

of cogeneration, utilities would be "depriv[ed] of the safeguards afforded by" the new Power Act provisions (Pet. App. B-22). As we have demonstrated, however, the limitation in Section 210(e)(3)(B) was necessary in order to make certain that the general exemption of qualifying facilities from the Power Act was not to be read as inconsistent with those new amendments to the Power Act that gave the Commission authority over *any* nonjurisdictional entity that sells electricity. Hence, to insure that the Commission did not reopen the regulatory gap that Congress had just closed, Congress, in Section 210(e)(3)(B), prohibited the Commission from exempting some of those entities—qualifying facilities—from the new authority granted to the Commission to order interconnections.[46]

It seems evident, therefore, that Section 210(e)(3)(B) does not address, much less restrict, the authority granted to the Commission under Section 210(a) of PURPA to require that electric utilities purchase electricity from and sell electricity to qualifying facilities. In seizing upon this provision as dispositive, the court below failed to "look to the provisions of the whole law, and to its object and policy" (*Pennhurst State School and Hospital* v. *Halderman*, 451 U.S. 1, 18 (1981)); as a result it departed completely from the intent of Congress. If the historically reluctant utilities may resist the required purchases and sales by challenging each facilitating interconnection in administrative and judicial proceedings, then Congress' effort to promote development of alterna-

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[46] Similarly, although the Commission may exempt qualifying facilities from state regulation, it is prohibited, in Section 210(e)(3)(A), from exempting qualifying facilities from any state law or regulation implementing Section 210 of PURPA. Here, too, Congress simply was assuring that the Commission would not undermine through regulations what Congress had sought to achieve in the statute.

tive sources of electricity will be stillborn. This Court should reject such a manifest distortion of the congressional purpose.[47]

CONCLUSION

The judgment of the court of appeals should be reversed.

Respectfully submitted.

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[47] The lower court's suggestion that the Commission could use "streamlined procedures" (Pet. App. B-23) cannot be squared with the statute's definition of "evidentiary hearing" (16 U.S.C. (Supp. V) 796(20)) as "a proceeding conducted as provided in sections 554, 556, and 557 of title 5, [United States Code,]" i.e., the Administrative Procedure Act. Moreover, each interconnection order under the Power Act is subject to judicial review under the substantial evidence test. See 16 U.S.C. 825*l*. The substantial evidence requirement would, as a practical matter, limit efforts to "streamline" proceedings.

APPENDIX

STATUTES AND REGULATIONS INVOLVED

1. Section 210 of PURPA, 16 U.S.C. (Supp. V) 824a-3, provides:

> (a) Not later than 1 year after the date of enactment of this Act, the Commission shall prescribe, and from time to time thereafter revise, such rules as it determines necessary to encourage cogeneration and small power production which rules require electric utilities to offer to—
>
> (1) sell electric energy to qualifying cogeneration facilities and qualifying small power production facilities and
>
> (2) purchase electric energy from such facilities.
>
> Such rules shall be prescribed, after consultation with representatives of Federal and State regulatory agencies having ratemaking authority for electric utilities, and after public notice and a reasonable opportunity for interested persons (including State and Federal agencies) to submit oral as well as written data, views, and arguments. Such rules shall include provisions respecting minimum reliability of qualifying cogeneration facilities and qualifying small power production facilities (including reliability of such facilities during emergencies) and rules respecting reliability of electric energy service to be available to such facilities from electric utilities during emergencies. Such rules may not authorize a qualifying cogeneration facility or qualifying small power production facility to make any sale for purposes other than resale.
>
> (b) The rules prescribed under subsection (a) shall insure that, in requiring any electric utility to offer to purchase electric energy from any qualifying

cogeneration facility or qualifying small power production facility, the rates for such purchase—

(1) shall be just and reasonable to the electric consumers of the electric utility and in the public interest, and

(2) shall not discriminate against qualifying cogenerators or qualifying small power producers.

No such rule prescribed under subsection (a) shall provide for a rate which exceeds the incremental cost to the electric utility of alternative electric energy.

(c) The rules prescribed under subsection (a) shall insure that, in requiring any electric utility to offer to sell electric energy to any qualifying cogeneration facility or qualifying small power production facility, the rates for such sale—

(1) shall be just and reasonable and in the public interest, and

(2) shall not discriminate against the qualifying cogenerators or qualifying small power producers.

(d) For purposes of this section, the term "incremental cost of alternative electric energy" means, with respect to electric energy purchased from a qualifying cogenerator or qualifying small power producer, the cost to the electric utility of the electric energy which, but for the purchase from such cogenerator or small power producer, such utility would generate or purchase from another source.

(e)(1) Not later than 1 year after the date of enactment of this Act and from time to time thereafter, the Commission shall, after consultation with representatives of State regulatory authorities, electric utilities, owners of cogeneration facilities and owners of small power production facilities, and after public notice and a reasonable opportunity for inter-

ested persons (including State and Federal agencies) to submit oral as well as written data, views, and arguments, prescribe rules under which qualifying cogeneration facilities and qualifying small power production facilities are exempted in whole or part from the Federal Power Act, from the Public Utility Holding Company Act, from State laws and regulations respecting the rates, or respecting the financial or organizational regulation, of electric utilities, or from any combination of the foregoing, if the Commission determines such exemption is necessary to encourage cogeneration and small power production.

(2) No qualifying small power production facility which has a power production capacity which, together with any other facilities located at the same site (as determined by the Commission), exceeds 30 megawatts may be exempted under rules under paragraph (1) from any provision of law or regulation referred to in paragraph (1), except that any qualifying small power production facility which produces electric energy solely by the use of biomass as a primary energy source, may be exempted by the Commission under such rules from the Public Utility Holding Company Act and from State laws and regulations referred to in such paragraph (1).

(3) No qualifying small power production facility or qualifying cogeneration facility may be exempted under this subsection from—

(A) any State law or regulation in effect in a State pursuant to subsection (f),

(B) the provisions of section 210, 211, or 212 of the Federal Power Act or the necessary authorities for enforcement of any such provision under the Federal Power Act, or

(C) any license or permit requirement under part I of the Federal Power Act, any provision under such Act related to such a license or

permit requirement, or the necessary authorities for enforcement of any such requirement.

(f) (1) Beginning on or before the date one year after any rule is prescribed by the Commission under subsection (a) or revised under such subsection, each State regulatory authority shall, after notice and opportunity for public hearing, implement such rule (or revised rule) for each electric utility for which it has ratemaking authority.

(2) Beginning on or before the date one year after any rule is prescribed by the Commission under subsection (a) or revised under such subsection, each nonregulated electric utility shall, after notice and opportunity for public hearing, implement such rule (or revised rule).

(g) (1) Judicial review may be obtained respecting any proceeding conducted by a State regulatory authority or nonregulated electric utility for purposes of implementing any requirement of a rule under subsection (a) in the same manner, and under the same requirements, as judicial review may be obtained under section 123 in the case of a proceeding to which section 123 applies.

(2) Any person (including the Secretary) may bring an action against any electric utility, qualifying small power producer, or qualifying cogenerator to enforce any requirement established by a State regulatory authority or nonregulated electric utility pursuant to subsection (f). Any such action shall be brought only in the manner, and under the requirements, as provided under section 123 with respect to an action to which section 123 applies.

(h) (1) For purposes of enforcement of any rule prescribed by the Commission under subsection (a) with respect to any operations of an electric utility, a qualifying cogeneration facility or a qualifying small power production facility which are subject to the jurisdiction of the Commission under part II of

the Federal Power Act, such rule shall be treated as a rule under the Federal Power Act. Nothing in subsection (g) shall apply to so much of the operations of an electric utility, a qualifying cogeneration facility or a qualifying small power production facility as are subject to the jurisdiction of the Commission under part II of the Federal Power Act.

(2) (A) The Commission may enforce the requirements of subsection (f) against any State regulatory authority or nonregulated electric utility. For purposes of any such enforcement, the requirements of subsection (f) (1) shall be treated as a rule enforceable under the Federal Power Act. For purposes of any such action, a State regulatory authority or nonregulated electric utility shall be treated as a person within the meaning of the Federal Power Act. No enforcement action may be brought by the Commission under this section other than—

(i) an action against the State regulatory authority or nonregulated electric utility for failure to comply with the requirements of subsection (f) or

(ii) an action under paragraph (1).

(B) Any electric utility, qualifying cogenerator, or qualifying small power producer may petition the Commission to enforce the requirements of subsection (f) as provided in subparagraph (A) of this paragraph. If the Commission does not initiate an enforcement action under subparagraph (A) against a State regulatory authority or nonregulated electric utility within 60 days following the date on which a petition is filed under this subparagraph with respect to such authority, the petitioner may bring an action in the appropriate United States district court to require such State regulatory authority or nonregulated electric utility to comply with such requirements, and such court may issue such injunc-

tive or other relief as may be appropriate. The Commission may intervene as a matter of right in any such action.

(i) No contract between a Federal agency and any electric utility for the sale of electric energy by such Federal agency for resale which is entered into after the date of the enactment of this Act may contain any provision which will have the effect of preventing the implementation of any rule under this section with respect to such utility. Any provision in any such contract which has such effect shall be null and void.

(j) For purposes of this section, the terms "small power production facility," "qualifying small power production facility," "qualifying small power producer," "primary energy source," "cogeneration facility," "qualifying cogeneration facility," and "qualifying cogenerator" have the respective meanings provided for such terms under section 3 (17) and (18) of the Federal Power Act.

2. Section 210 of the Federal Power Act, 16 U.S.C. (Supp. V) 824i, provides:

(a) (1) Upon application of any electric utility, Federal power marketing agency, geothermal power producer (including a producer which is not an electric utility), qualifying cogenerator, or qualifying small power producer, the Commission may issue an order requiring—

(A) the physical connection of any cogeneration facility, any small power production facility, or the transmission facilities of any electric utility, with the facilities of such applicant.

(B) such action as may be necessary to make effective any physical connection described in subparagraph (A), which physical connection is ineffective for any reason, such as inadequate size, poor maintenance, or physical unreliability,

(C) such sale or exchange of electric energy or other coordination, as may be necessary to carry out the purposes of any order under subparagraph (A) or (B), or

(D) such increase in transmission capacity as may be necessary to carry out the purposes of any order under subparagraph (A) or (B).

(2) Any State regulatory authority may apply to the Commission for an order for any action referred to in subparagraph (A), (B), (C), or (D) of paragraph (1). No such order may be issued by the Commission with respect to a Federal power marketing agency upon application of a State regulatory authority.

(b) Upon receipt of an application under subsection (a) of this section, the Commission shall—

(1) issue notice to each affected State regulatory authority, each affected electric utility, each affected Federal power marketing agency, each affected owner or operator of a cogeneration facility or of a small power production facility, and to the public.

(2) afford an opportunity for an evidentiary hearing, and

(3) make a determination with respect to the matters referred to in subsection (c) of this section.

(c) No order may be issued by the Commission under subsection (a) of this section unless the Commission determines that such order—

(1) is in the public interest,

(2) would—

(A) encourage overall conservation of energy or capital,

(B) optimize the efficiency of use of facilities and resources, or

(C) improve the reliability of any electric utility system or Federal power marketing agency to which the order applies, and

(3) meets the requirements of section 824k of this title.

(d) The Commission may, on its own motion, after compliance with the requirements of paragraphs (1) and (2) of subsection (b) of this section, issue an order requiring any action described in subsection (a)(1) of this section if the Commission determines that such order meets the requirements of subsection (c) of this section. No such order may be issued upon the Commission's own motion with respect to a Federal power marketing agency.

(e)(1) As used in this section, the term "facilities" means only facilities used for the generation or transmission of electric energy.

(2) With respect to an order issued pursuant to an application of a qualifying cogenerator or qualifying small power producer under subsection (a)(1) of this section, the term "facilities of such applicant" means the qualifying cogeneration facilities or qualifying small power production facilities of the applicant, as specified in the application. With respect to an order issued pursuant to an application under subsection (a)(2) of this section, the term "facilities of such applicant" means the qualifying cogeneration facilities, qualifying small power production facilities, or the transmission facilities of an electric utility, as specified in the application. With respect to an order issued by the Commission on its own motion under

subsection (d) of this section, such term means the qualifying cogeneration facilities, qualifying small power production facilities, or the transmission facilities of an electric utility, as specified in the proposed order.

2. Section 211 of the Federal Power Act, 16 U.S.C. (Supp. V) 824j, provides:

(a) Any electric utility, geothermal power producer (including a producer which is not an electric utility), or Federal power marketing agency may apply to the Commission for an order under this subsection requiring any other electric utility to provide transmission services to the applicant (including any enlargement of transmission capacity necessary to provide such services). Upon receipt of such application, after public notice and notice to each affected State regulatory authority, each affected electric utility, and each affected Federal power marketing agency, and after affording an opportunity for an evidentiary hearing, the Commission may issue such order if it finds that such order—

(1) is in the public interest,

(2) would—

(A) conserve a significant amount of energy,

(B) significantly promote the efficient use of facilities and resources, or

(C) improve the reliability of any electric utility system to which the order applies, and

(3) meets the requirements of section 824k of this title.

(b) Any electric utility, or Federal power marketing agency, which purchases electric energy for resale from any other electric utility may apply to the

Commission for an order under this subsection requiring such other electric utility to provide transmission services to the applicant (including any increase in transmission capacity necessary to provide such services). Upon receipt of an application under this subsection, after public notice and notice to each affected State regulatory authority, each affected electric utility, and each affected Federal power marketing agency, and after affording an opportunity for an evidentiary hearing, the Commission may issue such an order if the Commission determines that—

(1) such other electric utility has given actual or constructive notice that it is unwilling or unable to provide electric service to the applicant and has been requested by the applicant to provide the transmission services requested in the application under this subsection, and

(2) such order meets the requirements of section 824k of this title.

(c) (1) No order may be issued under subsection (a) unless the Commission determines that such order would reasonably preserve existing competitive relationships.

(2) No order may be issued under subsection (a) or (b) which requires the electric utility subject to the order to transmit, during any period, an amount of electric energy which replaces any amount of electric energy—

(A) required to be provided to such applicant pursuant to a contract during such period, or

(B) currently provided to the applicant by the utility subject to the order pursuant to a rate schedule on file during such period with the Commission.

(3) No order may be issued under the authority of subsection (a) or (b) which is inconsistent with

any State law which governs the retail marketing areas of electric utilities.

(4) No order may be issued under subsection (a) or (b) which provides for the transmission of electric energy directly to an ultimate consumer.

(d) (1) Any electric utility ordered under subsection (a) or (b) to provide transmission services may apply to the Commission for an order permitting such electric utility to cease providing all, or any portion of, such services. After public notice, notice to each affected State regulatory authority, each affected Federal power marketing agency, and each affected electric utility, and after an opportunity for an evidentiary hearing, the Commission shall issue an order terminating or modifying the order issued under subsection (a) or (b), if the electric utility providing such transmission services has demonstrated, and the Commission has found, that—

(A) due to changed circumstances, the requirements applicable, under this section and section 824k of this title, to the issuance of an order under subsection (a) or (b) are no longer met, or

(B) any transmission capacity of the utility providing transmission services under such order which was, at the time such order was issued, in excess of the capacity necessary to serve its own customers is no longer in excess of the capacity necessary for such purposes.

No order shall be issued under this subsection pursuant to a finding under subparagraph (A) unless the Commission finds that such order is in the public interest.

(2) Any order issued under this subsection terminating or modifying an order issued under subsection (a) or (b) shall—

(A) provide for any appropriate compensation, and

(B) provide the affected electric utilities adequate opportunity and time to—

(i) make suitable alternative arrangements for any transmission services terminated or modified, and

(ii) insure that the interests of ratepayers of such utilities are adequately protected.

(3) No order may be issued under this subsection terminating or modifying any order issued under subsection (a) or (b) if the order under subsection (a) or (b) includes terms and conditions agreed upon by the parties which—

(A) fix a period during which transmission services are to be provided under the order under subsection (a) or (b), or

(B) otherwise provide procedures or methods for terminating or modifying such order (including, if appropriate, the return of the transmission capacity when necessary to take into account an increase, after the issuance of such order, in the needs of the electric utility subject to such order for transmission capacity).

(e) As used in this section, the term "facilities" means only facilities used for the generation or transmission of electric energy.

3. Section 212 of the Federal Power Act, 16 U.S.C. (Supp. V) 824k, provides in pertinent part:

(a) No order may be issued by the Commission under section 824i or subsection (a) or (b) of section 824j of this title unless the Commission determines that such order—

(1) is not likely to result in a reasonably ascertainable uncompensated economic loss for any electric utility, qualifying cogenerator, or

qualifying small power producer, as the case may be, affected by the order;

(2) will not place an undue burden on an electric utility, qualifying cogenerator, or qualifying small power producer, as the case may be, affected by the order;

(3) will not unreasonably impair the reliability of any electric utility affected by the order; and

(4) will not impair the ability of any electric utility affected by the order to render adequate service to its customers.

The determination under paragraph (1) shall be based upon a showing of the parties. The Commission shall have no authority under section 824i or 824j of this title to compel the enlargement of generating facilities.

(b) No order may be issued under section 824i or subsection (a) or (b) of section 824j of this title unless the applicant for such order demonstrates that he is ready, willing, and able to reimburse the party subject to such order for—

(1) in the case of an order under section 824i of this title, such party's share of the reasonably anticipated costs incurred under such order, and

(2) in the case of an order under subsection (a) or (b) of section 824j of this title—

(A) the reasonable costs of transmission services, including the costs of any enlargement of transmission facilities, and

(B) a reasonable rate of return on such costs, as appropriate, as determined by the Commission.

(c) (1) Before issuing an order under section 824i or subsection (a) or (b) of section 824j of this

title, the Commission shall issue a proposed order and set a reasonable time for parties to the proposed interconnection or transmission order to agree to terms and conditions under which such order is to be carried out, including the apportionment of costs between them and the compensation or reimbursement reasonably due to any of them. Such proposed order shall not be reviewable or enforceable in any court. The time set for such parties to agree to such terms and conditions may be shortened if the Commission determines that delay would jeopardize the attainment of the purposes of any proposed order. Any terms and conditions agreed to by the parties shall be subject to the approval of the Commission.

(2) (A) If the parties agree as provided in paragraph (1) within the time set by the Commission and the Commission approves such agreement, the terms and conditions shall be included in the final order. In the case of an order under section 824i of this title, if the parties fail to agree within the time set by the Commission or if the Commission does not approve any such agreement, the Commission shall prescribe such terms and conditions and include such terms and conditions in the final order.

(B) In the case of any order applied for under section 824j of this title, if the parties fail to agree within the time set by the Commission, the Commission shall prescribe such terms and conditions in the final order.

(d) If the Commission does not issue any order applied for under section 824i or 824j or this title, the Commission shall, by order, deny such application and state the reasons for such denial.

(e) No provision of section 824i or 824j of this title shall be treated—

(1) as requiring any person to utilize the authority of such section 824i or 824j of this title in lieu of any other authority of law, or

(2) as limiting, impairing, or otherwise affecting any authority of the Commission under any other provision of law.

4. 18 C.F.R. Subchapter K provides in pertinent part:

SUBPART A—GENERAL PROVISIONS

§ 292.101 *Definitions.*

(a) *General rule.* Terms defined in the Public Utility Regulatory Policies Act of 1978 (PURPA) shall have the same meaning for purposes of this part as they have under PURPA, unless further defined in this part.

(b) *Definitions.* The following definitions apply for purposes of this part.

(1) "Qualifying facility" means a cogeneration facility or a small power production facility which is a qualifying facility under Subpart B of this part of the Commission's regulations.

(2) "Purchase" means the purchase of electric energy or capacity or both from a qualifying facility by an electric utility.

(3) "Sale" means the sale of electric energy or capacity or both by an electric utility to a qualifying facility.

(4) "System emergency" means a condition on a utility's system which is likely to result in imminent significant disruption of service to customers or is imminently likely to endanger life or property.

(5) "Rate" means any price, rate, charge, or classification made, demanded, observed or received with respect to the sale or purchase of electric energy or capacity, or any rule, regulation, or practice respecting any such rate, charge, or classification, and any contract pertaining to the sale or purchase of electric energy or capacity.

(6) "Avoided costs" means the incremental costs to an electric utility of electric energy or capacity or both which, but for the purchase from the qualifying facility or qualifying facilities, such utility would generate itself or purchase from another source.

(7) "Interconnection costs" means the reasonable costs of connection, switching, metering, transmission, distribution, safety provisions and administrative costs incurred by the electric utility directly related to the installation and maintenance of the physical facilities necessary to permit interconnected operations with a qualifying facility, to the extent such costs are in excess of the corresponding costs which the electric utility would have incurred if it had not engaged in interconnected operations, but instead generated an equivalent amount of electric energy itself or purchased an equivalent amount of electric energy or capacity from other sources. Interconnection costs do not include any costs included in the calculation of avoided costs.

(8) "Supplementary power" means electric energy or capacity supplied by an electric utility, regularly used by a qualifying facility in addition to that which the facility generates itself.

(9) "Back-up power" means electric energy or capacity supplied by an electric utility to replace energy ordinarily generated by a facility's own generation equipment during an unscheduled outage of the facility.

(10 "Interruptible power" means electric energy or capacity supplied by an electric utility subject to interruption by the electric utility under specified conditions.

(11) "Maintenance power" means electric energy or capacity supplied by an electric utility during scheduled outages of the qualifying facility.

SUBPART B—[RESERVED]

SUBPART C—ARRANGEMENTS BETWEEN ELECTRIC UTILITIES AND QUALIFYING COGENERATION AND SMALL POWER PRODUCTION FACILITIES UNDER SECTION 210 OF THE PUBLIC UTILITY REGULATORY POLICIES ACT OF 1978

§ 292.301 *Scope.*

(a) *Applicability.* This subpart applies to the regulation of sales and purchases between qualifying facilities and electric utilities.

(b) *Negotiated rates or terms.* Nothing in this subpart:

(1) limits the authority of any electric utility or any qualifying facility to agree to a rate for any purchase, or terms or conditions relating to any purchase, which differ from the rate or terms or conditions which would otherwise be required by this subpart; or

(2) affects the validity of any contract entered into between a qualifying facility and an electric utility for any purchase.

§ 292.302 *Availability of electric utility system cost data.*

(a) *Applicability.* (1) Except as provided in subparagraph (2), paragraph (b) applies to each electric utility, in any calendar year, if the total sales of electric energy by such utility for purposes other than resale exceeded 500 million kilowatt-hours during any calendar year beginning after December 31, 1975, and before the immediately preceding calendar year.

(2) Each utility having total sales of electric energy for purposes other than resale of less than one billion kilowatt-hours during any calendar year beginning after December 31, 1975, and before the im-

mediately preceding year, shall not be subject to the provisions of this section until May 31, 1982.

(b) *General rule.* To make available data from which avoided costs may be derived, not later than November 1, 1980, May 31, 1982, and not less often than every two years thereafter, each regulated electric utility described in paragraph (a) shall provide to its State regulatory authority, and shall maintain for public inspection, and each nonregulated electric utility described in paragraph (a) shall maintain for public inspection, the following data:

(1) the estimated avoided cost on the electric utility's system, solely with respect to the energy component, for various levels of purchases from qualifying facilities. Such levels of purchases shall be stated in blocks of not more than 100 megawatts for systems with peak demand of 1000 megawatts or more, and in blocks equivalent to not more than 10 percent of the system peak demand for systems of less than 1000 megawatts. The avoided costs shall be stated on a cents per kilowatt-hour basis, during daily and seasonal peak and off-peak periods, by year, for the current calendar year and each of the next 5 years;

(2) the electric utility's plan for the addition of capacity by amount and type, for purchases of firm energy and capacity, and for capacity retirements for each year during the succeeding 10 years; and

(3) the estimated capacity costs at completion of the planned capacity additions and planned capacity firm purchases, on the basis of dollars per kilowatt, and the associated energy costs of each unit, expressed in cents per kilowatt hour. These costs shall be expressed in terms of individual generating units and of individual planned firm purchases.

(c) *Special rule for small electric utilities.*

(1) Each electric utility (other than any electric utility to which paragraph (b) applies) shall, upon request:

(i) provide comparable data to that required under paragraph (b) to enable qualifying facilities to estimate the electric utility's avoided costs for periods described in paragraph (b); or

(ii) with regard to an electric utility which is legally obligated to obtain all its requirements for electric energy and capacity from another electric utility, provide the data of its supplying utility and the rates at which it currently purchases such energy and capacity.

(2) If any such electric utility fails to provide such information on request, the qualifying facility may apply to the State regulatory authority (which has ratemaking authority over the electric utility) or the Commission for an order requiring that the information be provided.

(d) *Substitution of alternative method.* (1) After public notice in the area served by the electric utility, and after opportunity for public comment, any State regulatory authority may require (with respect to any electric utility over which it has ratemaking authority), or any nonregulated electric utility may provide, data different than those which are otherwise required by this section if it determines that avoided costs can be derived from such data.

(2) Any State regulatory authority (with respect to any electric utility over which it has ratemaking authority) or nonregulated utility which requires such different data shall notify the Commission within 30 days of making such determination.

(e) *State review.* (1) Any data submitted by an electric utility under this section shall be subject to review by the State regulatory authority which has ratemaking authority over such electric utility.

(2) In any such review, the electric utility has the burden of coming forward with justification for its data.

§ 292.303 *Electric utility obligations under the subpart.*

(a) *Obligation to purchase from qualifying facilities.* Each electric utility shall purchase, in accordance with § 292.304, any energy and capacity which is made available from a qualifying facility:

(1) directly to the electric utility; or

(2) indirectly to the electric utility in accordance with paragraph (d).

(b) *Obligation to sell to qualifying facilities.* Each electric utility shall sell to any qualifying facility, in accordance with § 292.305, any energy and capacity requested by the qualifying facility.

(c) *Obligation to interconnect.* (1) Subject to subparagraph (2), any electric utility shall make such interconnections with any qualifying facility as may be necessary to accomplish purchases or sales under this subpart. The obligation to pay for any interconnection costs shall be determined in accordance with § 292.306.

(2) No electric utility is required to interconnect with any qualifying facility if, solely by reason of purchases or sales over the interconnection, the electric utility would become subject to regulation as a public utility under Part II of the Federal Power Act.

(d) *Transmission to other electric utilities.* If a qualifying facility agrees, an electric utility which would otherwise be obligated to purchase energy or capacity from such qualifying facility may transmit the energy or capacity to any other electric utility. Any electric utility to which such energy or capacity is transmitted shall purchase such energy capacity under this subpart as if the qualifying facility were supplying energy or capacity directly to such electric utility. The rate for purchase by the electric utility to which such energy is transmitted shall be adjusted

up or down to reflect line losses pursuant to § 292.304(e)(4) and shall not include any charges for transmission.

(e) *Parallel operation.* Each electric utility shall offer to operate in parallel with a qualifying facility, provided that the qualifying facility complies with any applicable standards established in accordance with § 292.308.

§ 292.304 *Rates for purchases.*

(a) *Rates for purchases.* (1) Rates for purchases shall:

(i) be just and reasonable to the electric consumer of the electric utility and in the public interest; and

(ii) not discriminate against qualifying cogeneration and small power production facilities.

(2) Nothing in this subpart requires any electric utility to pay more than the avoided costs for purchases.

(b) *Relationship to avoided costs.* (1) For purposes of this paragraph, "new capacity" means any purchase from capacity of a qualifying facility, construction of which was commenced on or after November 9, 1978.

(2) Subject to subparagraph (3), a rate for purchases satisfies the requirements of paragraph (a) if the rate equals the avoided costs determined after consideration of the factors set forth in paragraph (e).

(3) A rate for purchases (other than from new capacity) may be less than the avoided cost if the State regulatory authority (with respect to any electric utility over which it has ratemaking authority) or the nonregulated electric utility determines that a lower rate is consistent with paragraph (a), and is sufficient to encourage cogeneration and small power production.

(4) Rates for purchases from new capacity shall be in accordance with subparagraph (2), regardless of whether the electric utility making such purchases is simultaneously making sales to the qualifying facility.

(5) In the case in which the rates for purchases are based upon estimates of avoided costs over the specific term of the contract or other legally enforceable obligation, the rates for such purchases do not violate this subpart if the rates for such purchases differ from avoided costs at the time of delivery.

(c) *Standard rates for purchases.* (1) There shall be put into effect (with respect to each electric utility) standard rates for purchases from qualifying facilities with a design capacity of 100 kilowatts or less.

(2) There may be put into effect standard rates for purchases from qualifying facilities with a design capacity of more than 100 kilowatts.

(3) The standard rates for purchases under this paragraph:

(i) shall be consistent with paragraphs (a) and (e); and

(ii) may differentiate among qualifying facilities using various technologies on the basis of the supply characteristics of the different technologies.

(d) *Purchases "as available" or pursuant to a legally enforceable obligation.* Each qualifying facility shall have the option either:

(1) to provide energy as the qualifying facility determines such energy to be available for such purchases, in which case the rates for such purchases shall be based on the purchasing utility's avoided costs calculated at the time of delivery; or

(2) to provide energy or capacity pursuant to a legally enforceable obligation for the delivery of energy or capacity over a specified term, in which case the rates for such purchases shall, at the option

of the qualifying facility exercised prior to the beginning of the specified term, be based on either:

(i) the avoided costs calculated at the time of delivery; or

(ii) the avoided costs calculated at the time the obligation is incurred.

(e) *Factors affecting rates for purchases.* In determining avoided costs, the following factors shall, to the extent practicable, be taken into account:

(1) the data provided pursuant to § 292.302(b), (c), or (d), including State review of any such data;

(2) the availability of capacity or energy from a qualifying facility during the system daily and seasonal peak periods, including:

(i) the ability of the utility to dispatch the qualifying facility;

(ii) the expected or demonstrated reliability of the qualifying facility;

(iii) the terms of any contract or other legally enforceable obligation, including the duration of the obligation, termination notice requirement and sanctions for non-compliance;

(iv) the extent to which scheduled outages of the qualifying facility can be usefully coordinated with scheduled outages of the utility's facilities;

(v) the usefulness of energy and capacity supplied from a qualifying facility during system emergencies, including its ability to separate its load from its generation;

(vi) the individual and aggregate value of energy and capacity from qualifying facilities on the electric utility's system; and

(vii) the smaller capacity increments and the shorter lead times available with additions of capacity from qualifying facilities; and

(3) the relationship of the availability of energy or capacity from the qualifying facility as derived in subparagraph (2), to the ability of the electric utility to avoid costs, including the deferral of capacity additions and the reduction of fossil fuel use; and

(4) the costs or savings resulting from variations in line losses from those that would have existed in the absence of purchases from a qualifying facility, if the purchasing electric utility generated an equivalent amount of energy itself or purchased an equivalent amount of electric energy or capacity.

(f) *Periods during which purchases not required.*

(1) Any electric utility which gives notice pursuant to subparagraph (2) will not be required to purchase electric energy or capacity during any period during which, due to operational circumstances, purchases from qualifying facilities will result in costs greater than those which the utility would incur if it did not make such purchases, but instead generated an equivalent amount of energy itself.

(2) Any electric utility seeking to invoke subparagraph (1) must notify, in accordance with applicable State law or regulation, each affected qualifying facility in time for the qualifying facility to cease the delivery of energy or capacity to the electric utility.

(3) Any electric utility which fails to comply with with the provisions of subparagraph (2) will be required to pay the same rate for such purchase of energy or capacity as would be required had the period described in subparagraph (1) not occurred.

(4) A claim by an electric utility that such a period has occurred or will occur is subject to such verification by its State regulatory authority as the State regulatory authority determines necessary or appropriate, either before or after the occurrence.

§ 292.305 *Rates for sales.*

(a) *General rules.* (1) Rates for sales:

(i) shall be just and reasonable and in the public interest; and

(ii) shall not discriminate against any qualifying facility in comparison to rates for sales to other customers served by the electric utility.

(2) Rates for sales which are based on accurate data and consistent systemwide costing principles shall not be considered to discriminate against any qualifying facility to the extent that such rates apply to the utility's other customers with similar load or other cost-related characteristics.

(b) *Additional Services to be Provided to Qualifying Facilities.* (1) Upon request of a qualifying facility, each electric utility shall provide:

(i) supplementary power;

(ii) back-up power;

(iii) maintenance power; and

(iv) interruptible power.

(2) The State regulatory authority (with respect to any electric utility over which it has ratemaking authority) and the Commission (with respect to any nonregulated electric utility) may waive any requirement of subparagraph (1) if, after notice in the area served by the electric utility and after opportunity for public comment, the electric utility demonstrates and the State regulatory authority or the Commission, as the case may be, finds that compliance with such requirement will:

(i) impair the electric utility's ability to render adequate service to its customers; or

(ii) place an undue burden on the electric utility.

(c) *Rates for sales of back-up and maintenance power.* The rate for sales of back-up power or maintenance power:

(1) shall not be based upon an assumption (unless supported by factual data) that forced outages or other reductions in electric output by all qualifying facilities on an electric utility's system will occur simultaneously, or during the system peak, or both; and

(2) shall take into account the extent to which scheduled outages of the qualifying facilities can be usefully coordinated with scheduled outages of the utility's facilities.

§ 292.306 *Interconnection costs.*

(a) *Obligation to pay.* Each qualifying facility shall be obligated to pay any interconnection costs which the State regulatory authority (with respect to any electric utility over which it has ratemaking authority) or nonregulated electric utility may assess against the qualifying facility on a nondiscriminatory basis with respect to other customers with similar load characteristics.

(b) *Reimbursement of interconnection costs.* Each State regulatory authority (with respect to any electric utility over which it has ratemaking authority) and nonregulated utility shall determine the manner for payments of interconnection costs, which may include reimbursement over a reasonable period of time.

§ 292.307 *System emergencies.*

(a) *Qualifying facility obligation to provide power during system emergencies.* A qualifying facility shall be required to provide energy or capacity to an electric utility during a system emergency only to the extent:

(1) provided by agreement between such qualifying facility and electric utility; or

(2) ordered under section 202(c) of the Federal Power Act.

(b) *Discontinuance of purchases and sales during system emergencies.* During any system emergency, an electric utility may discontinue:

(1) purchases from a qualifying facility if such purchases would contribute to such emergency; and

(2) sales to a qualifying facility, provided that such discontinuance is on a nondiscriminatory basis.

§ 292.308 *Standards for operating reliability.*

Any State regulatory authority (with respect to any electric utility over which it has ratemaking authority) or nonregulated electric utility may establish reasonable standards to ensure system safety and reliability of interconnected operations. Such standards may be recommended by any electric utility, any qualifying facility, or any other person. If any State regulatory authority (with respect to any electric utility over which it has ratemaking authority) or nonregulated electric utility establishes such standards, it shall specify the need for such standards on the basis of system safety and reliability.

SUBPART D—IMPLEMENTATION

§ 292.401 *Implementation by State regulatory authorities and nonregulated electric utilities.*

(a) *State regulatory authorities.* Not later than one year after these rules take effect, each State regulatory authority shall, after notice and an opportunity for public hearing, commence implementation of Subpart C (other than § 292.302 thereof). Such implementation may consist of the issuance of regulations, an undertaking to resolve disputes between qualifying facilities and electric utilities arising under Subpart C, or any other action reasonably

designed to implement such subpart (other than § 292.302 thereof).

(b) *Nonregulated electric utilities.* Not later than one year after these rules take effect, each nonregulated electric utility shall, after notice and an opportunity for public hearing, commence implementation of Subpart C (other than § 292.302 thereof). Such implementation may consist of the issuance of regulations, an undertaking to comply with Subpart C, or any other action reasonably designed to implement such subpart (other than § 292.302 thereof).

(c) *Reporting requirement.* Not later than one year after these rules take effect, each State regulatory authority and nonregulated electric utility shall file with the Commission a report describing the manner in which it will implement Subpart C (other than § 292.302 thereof).

§ 292.402 *Implementation of Certain Reporting Requirements.*

Any electric utility which fails to comply with the requirements of § 292.302(b) shall be subject to the same penalties to which it may be subjected for failure to comply with the requirements of the Commission's regulations issued under section 133 of PURPA.

§ 292.403 *Waivers.*

(a) *State regulatory authority and nonregulated electric utility waivers.* Any State regulatory authority (with respect to any electric utility over which it has ratemaking authority) or nonregulated electric utility may, after public notice in the area served by the electric utility, apply for a waiver from the application of any of the requirements of Subpart C (other than § 292.302 thereof).

(b) *Commission action.* The Commission will grant such a waiver only if an applicant under para-

graph (a) demonstrates that compliance with any of the requirements of Subpart C is not necessary to encourage cogeneration and small power production and is not otherwise required under section 210 of PURPA.

* * * * *

SUBPART F—EXEMPTION OF QUALIFYING SMALL POWER PRODUCTION FACILITIES AND COGENERATION FACILITIES FROM CERTAIN FEDERAL AND STATE LAWS AND REGULATIONS

§ 292.601 *Exemption to qualifying facilities from the Federal Power Act.*

(a) *Applicability.* This section applies to:

(1) qualifying cogeneration facilities; and

(2) qualifying small power production facilities which have a power production capacity which does not exceed 30 megawatts.

(b) *General rule.* Any qualifying facility described in paragraph (a) shall be exempt from all sections of the Federal Power Act, except:

(1) sections 1-30;

(2) sections 202(c), 210, 211, and 212;

(3) section 305(c); and

(4) any necessary enforcement provision of Part III with regard to the sections listed in subparagraphs (1), (2) and (3).

§ 292.602 *Exemption to qualifying facilities from the Public Utility Holding Company Act and certain State law and regulation.*

(a) *Applicability.* This section applies to any qualifying facility described in § 292.601(a), and to any qualifying small power production facility with a power production capacity over 30 megawatts if such facility produces electric energy solely by the use of biomass as a primary energy source.

(b) *Exemption from the Public Utility Holding Company Act of 1935.* A qualifying facility described in paragraph (a) shall not be considered to be an "electric utility company" as defined in section 2(a)(3) of the Public Utility Holding Company Act of 1935, 15 U.S.C. § 79b(a)(3).

(c) *Exemption from certain State law and regulation.*

(1) Any qualifying facility shall be exempted (except as provided in subparagraph (2)) from State law or regulation respecting:

(i) the rates of electric utilities; and

(ii) the financial and organizational regulation of electric utilities.

(2) A qualifying facility may not be exempted from State law and regulation implementing Subpart C.

(3) Upon request of a State regulatory authority or nonregulated electric utility, the Commission may consider a limitation on the exemptions specified in subparagraph (1).

(4) Upon request of any person, the Commission may determine whether a qualifying facility is exempt from a particular State law or regulation.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1982

AMERICAN PAPER INSTITUTE, INC.,
Petitioner,
—v.—
AMERICAN ELECTRIC POWER SERVICE CORP., *et al.*,
Respondents.

FEDERAL ENERGY REGULATORY COMMISSION,
Petitioner,
—v.—
AMERICAN ELECTRIC POWER SERVICE CORP., *et al.*,
Respondents.

ON WRITS OF CERTIORARI TO THE UNITED STATES
COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

REPLY BRIEF FOR PETITIONER AMERICAN PAPER INSTITUTE, INC.

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ON WRITS OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

REPLY BRIEF FOR PETITIONER AMERICAN PAPER INSTITUTE, INC.

ARGUMENT

The Public Utility Regulatory Policies Act of 1978 was only one part of a package of legislation signed into law on November 9, 1978, designed to combat a nationwide energy crisis.[1] PURPA itself had six separate titles.[2] Two of them,

1 In addition to PURPA, the package included the Energy Tax Act of 1978, Pub. L. No. 95-618, 92 Stat. 3174; the National Energy Conservation Policy Act, Pub. L. No. 95-619, 92 Stat. 3206; the Powerplant and Industrial Fuel Use Act of 1978, Pub. L. No. 95-620, 92 Stat. 3289; and the Natural Gas Policy Act of 1978, Pub. L. No. 95-621, 92 Stat. 3351.

2 Title I—Retail Regulatory Policies for Electric Utilities; Title II—Certain Federal Energy Regulatory Commission and Department of

Titles I and III, relate to regulatory policies for electric and gas utilities and seek to create immediate benefits for consumers.[3] Section 210 of Title II, on the other hand, had a different emphasis. It clearly set forth Congressional intention that FERC was, by rule, to encourage alternative energy sources. In Section 210(a) it directed that within one year FERC "shall prescribe, and from time to time thereafter revise, such rules as it determines necessary to encourage cogeneration and small power production." The Court of Appeals below, respondents, and their *amicus curiae* Edison Electric Institute ("EEI") have lost sight of this unequivocal expression of Congressional intention. Accordingly, this reply brief is submitted by API to address certain misconceptions of respondents and EEI reflected in their briefs to this Court.

I.

THE AVOIDED COSTS RULE COMPLIES WITH THE STATUTE

a. Respondents' basic argument is that the Congressional direction contained in PURPA Section 210(a)—that FERC's rules should encourage cogeneration and small power production—must be subordinated in FERC's rules to the short-term interests of utility ratepayers. Specifically, they argue that the possibility that utility ratepayers might obtain immediate rate benefits from the program—regardless of how insignificant[4]—

Energy Authorities; Title III—Retail Policies for Natural Gas Utilities; Title IV—Small Hydroelectric Power Projects; Title V—Crude Oil Transportation Systems; and Title VI—Miscellaneous Provisions.

3 As this Court observed in *FERC* v. *Mississippi*, ____ U.S. ____, 102 S. Ct. 2126, 2130 (June 1, 1982):

> "The Titles share three goals: (1) to encourage 'conservation of energy supplied by . . . utilities;' (2) to encourage 'the optimization of the efficiency of use of facilities and resources' by utilities; and (3) to encourage 'equitable rates . . . to consumers.' "

4 Respondents and EEI chastise the Commission for saying that rate reductions will be insignificant for any individual customer, and respondents suggest that an 80% avoided costs purchase rate could save consumers vast sums. (Res. Br., p. 16 n.14; EEI Br., p. 21.) The

must be read into PURPA Section 210 even though no such requirement is stated. Instead, they urge that the just and reasonable language contained in Section 210(b) effectively overrides all other provisions in Section 210. They do so by arguing that the phrase "just and reasonable" has a "well understood rate-related meaning," and this requires FERC to set a purchase rate under PURPA that will assure ratepayers immediate rate benefits from the program. (Res. Br., p. 20.) They are wrong.

The conference report accompanying PURPA made it clear that, when dealing with purchase rates, the just and reasonable language in PURPA Section 210(b) did not have the traditional rate-related meaning. Thus, it was not to be construed to require the purchase rate from qualifying facilities be subject "to the type of examination that is traditionally given to electric utility rate applications to determine what is the just and reasonable rate that they should receive for their electric power." H.R. Rep. No. 95-1750, 95th Cong., 2d Sess., p. 97 (1978). By contrast, PURPA Section 210(c), dealing with sales rates to qualifying facilities, also contained the just and reasonable language. The committee report clearly differentiated between the two sections stating "[h]ere the phrase 'just and reasonable' is intended to refer to traditional utility ratemaking concepts. The conferees do not intend that the cogenerator or small power producer pay any more or any less than is otherwise just and reasonable in terms of the utility receiving the reasonable rate of return for providing service to those kinds of users." *Id.* at 98.

Respondents are therefore wrong when they suggest that the just and reasonable language of Section 210(b) requires the

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fallacy in this suggestion is that the Nation's supply of electricity will not be increased by alternative energy sources if the purchase rate is too low. As we discussed in our principal brief (pp. 20-22), absent a high enough purchase rate, qualifying facilities simply will not be built. The estimate of "massive potential for cogeneration and small power production" (Res. Br., p. 16) is based upon a purchase rate which encourages them precisely as Congress said FERC's rules should.

same type of analysis as with a utility's rates to its customers. FERC was not obligated to apply a similar ratemaking analysis in establishing the purchase rate for sales by PURPA-induced cogenerators and small power producers.

Even a traditional ratemaking analysis would not require FERC to establish a purchase rate which provides immediate short-term rate benefits to utility ratepayers. In *FPC* v. *Memphis Light, Gas & Water Div.*, 411 U.S. 458, 465-66 (1973), this Court considered the just and reasonable standard under the Natural Gas Act and quoted from *FPC* v. *Hope Natural Gas Co.*, 320 U.S. 591 (1944):

> "In the early case of *FPC* v. *Hope Natural Gas Co.*, 320 U.S. 591, we emphasized two aspects of the power of the Commission to fix 'just and reasonable' rates under 15 U.S.C. § 717. First, was the desire 'to protect consumers against exploitation,' 320 U.S., at 610, and second, was the aim to promote the 'financial integrity' of the natural gas companies as measured, not only by revenues sufficient to recover operating expenses and capital costs, *id.*, at 603, but also by revenues 'sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and to attract capital.' *Ibid.*"

Indeed, this Court reversed the Court of Appeals for the District of Columbia Circuit "*in toto*," because:

> "Its holding that the consumer interests were not furthered by the Commission's action is short of the application of the appropriate standard for review. As already noted, under *Hope Natural Gas* rates are 'just and reasonable' only if consumer interests are protected and if the financial health of the pipeline in our economic system remains strong." 411 U.S. at 474.

Here, of course, FERC protected the interests of utility ratepayers while at the same time encouraging new alternative energy projects. It said that "utilities' customers are kept whole, and pay the same rates as they would have paid had the utility not purchased energy and capacity from the qualifying

facility." B-65. FERC was not required to "further" the ratepayers' interests even under the traditional rate-related meaning.

b. Respondents and EEI compress the provisions in PURPA Section 210(b) that rates be just and reasonable to the electric consumers of the utility, in the public interest and non-discriminatory against qualifying facilities as though the only consideration was the "just and reasonable" one. (Res. Br., pp. 13, 20, 21, 22; EEI Br., pp. 19, 20, 21, 22, 23, 25, 26, 29, 30.) Respondents then argue that the Commission did not consider whether a rate which would satisfy their definition of the statutory criteria could be established. (Res. Br., p. 13.) Respondents are mistaken.

In the Staff Discussion Paper issued by FERC in July 1979, JA 6, the Staff noted that "so long as the service being offered by" the qualifying facility "is fully comparable to the alternative, the payment to the cogenerator of the full cost of the alternative would be just and reasonable to the utility's customers." JA 30, n.11. However, the Commission invited the utilities to suggest some other rate, stating:

> "Thus we have difficulty in describing some particular price other than the avoided cost as being just and reasonable to the utility's customers." *Id.*

Respondents now criticize FERC for failing "to examine carefully the possibility of adopting a purchase rate rule that set rates *below* the statutory maximum of full avoided cost." (Res. Br., p. 25; emphasis in original.) But the utilities failed to make even a minimal effort during the rulemaking proceedings to furnish a rational basis for establishing a purchase rate at less than avoided costs, yet still comply with Congress' direction that FERC's rules should "encourage cogeneration and small power production."[5] As the Commission Staff observed,

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5 The Court of Appeals panel acknowledged this failure by the utilities when it directed that on remand the utilities be given the opportunity to "demonstrate" that a "percentage of avoided costs approach" might

"[w]e do *not* understand the prescription that the proper price is the lower of the just and reasonable price and the avoided cost as requiring that the selling [qualifying facility] be restricted to a minimal mark-up from its marginal generation cost on its sales to a utility."[6] JA 30, n.11; emphasis in original.

In this light, the Commission's explanation in its Order of its reasons for adopting an avoided costs purchase rate for new facilities offered the reasoned explanation required by the Administrative Procedure Act. Among other things, it said that "purchases of energy or capacity from qualifying facilities will occur only when the cost to the qualifying cogenerator or small power producer of producing the energy or capacity is lower than the utility's avoided costs. Only if this is the case will payment by the utility of its avoided costs provide economic benefit for the cogenerator or small power producer." B-64. This explanation expressed "the determinative reason for the final action taken" as required by *Camp* v. *Pitts*, 411 U.S. 138, 143 (1973). Respondents cannot successfully urge that the Court of Appeals was free to set aside that determination because it disagreed with the conclusion.

c. Both respondents' brief and the brief of EEI grossly misapprehend the operation of the purchase rate rule. They assert that under the rule new qualifying facilities will always

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pass muster. B-12. During the rulemaking, however, utilities only urged a "split-the-savings" rate, which would have required a detailed examination of the costs of the qualifying facilities. FERC rejected this approach as contrary to Congressional intention, B-65, and the Court of Appeals agreed, B-11.

6 The conference report recognized that if the program were to succeed, potential producers required financial incentives to justify the risks and expenses entailed in such projects. "The conferees recognize that cogenerators and small power producers are different from electric utilities, not being guaranteed a rate of return on their activities generally or on the activities vis a vis the sale of power to the utility and whose risk in proceeding forward in the cogeneration or small power production enterprise is not guaranteed to be recoverable." H.R. Rep. 95-1750, *supra*, at pp. 97-98.

receive the full avoided costs of the utility, implying that this invariably means a rate based on the utility's highest cost power. They are wrong on both counts.

As the Commission observed in its Order, there are two distinct elements in a utility's costs. One element, called "energy" costs, is "the variable costs associated with the production of electric energy (kilowatt-hours). They represent the cost of fuel, and some operating and maintenance expenses." B-43, 44. The second element, referred to as "capacity" costs, is "the costs associated with providing the capability to deliver energy; they consist primarily of the capital costs of facilities." B-44. The energy costs and the capacity costs together constitute the utility's avoided costs. 18 C.F.R. § 292.101(b)(6); B-43. Under the Commission's rules, however, although utilities are required to offer to purchase energy or capacity from qualifying facilities, the purchase rate initially set[7] at full avoided costs need be paid to newly constructed facilities only if those costs can truly be avoided by the utility.

In calculating avoided costs, the rules provide that, absent agreement between the parties, the calculation is made either at the time the power is delivered or, if the qualifying facility incurs a legally enforceable obligation to deliver power over a specified term, at the time that obligation is incurred. 18 C.F.R. § 292.304(d). Absent a contract, a qualifying facility delivering power throughout the day receives an avoided costs purchase rate calculated at the time of delivery during the day and not just when the utility is operating its highest cost units.

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7 Unlike the Court of Appeals and respondents, the Commission recognized that at the time of the rulemaking extensive experience with alternative energy sources was lacking, and it was difficult to predict with any degree of assurance the specific consequences of any particular rate for purchases from new facilities. "The Commission also continues to believe," it said in the Order, "that this rulemaking represents an effort to evolve concepts in a newly developing area within certain statutory constraints." B-77.

A utility normally operates only its base load units—which are its lowest cost units—during periods of lowest demand, *e.g.*, the late night or early morning hours. During those periods, the utility's avoided costs would be very low, amounting to no more than its energy costs, since the qualifying facility delivering power without a contract is not making available any usable capacity to the utility.[8] Thus, since energy costs are the only costs the utility might avoid when it takes power from a qualifying facility during periods of low loads, it is only those costs which determine the purchase rate under the Commission's rules.

As the day progresses, utilities normally experience a growth in system load as more and more customers begin to use power. Most utilities have sufficient capacity available to meet normal system loads and, therefore, even at higher loads, the qualifying facility delivering power without a contract will not be making capacity available. It will, therefore, be entitled to a purchase rate based only on the energy costs that the utility avoids. At peak loads, some utilities require "peakers," which are higher cost units since they require more expensive fuels to generate power. Under the Commission's rules, a qualifying facility delivering power at that time is entitled to a purchase rate based on the avoided costs of that more expensive fuel.[9]

To illustrate, a utility operating at 2 a.m. may need only its low cost base load unit, the energy cost of which is, say, 2.345¢

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8 The rules provide that although the utility is required to offer to purchase the power, "the purchase rate should only include payment for energy or capacity which the utility can use to meet its total system load." B-53.

9 The Commission recognized that the ability of a utility to control power production "enhances a utility's ability to respond to changes in demand, and thereby enhances the value of that power to the utility." B-79. Accordingly, the rules provide that one of the factors to be taken into account in determining avoided costs is the willingness or ability of the qualifying facility to enter into an arrangement allowing the utility to dispatch—control the flow of—the facility's power. 18 C.F.R. § 292.304(e)(2)(i).

per kwh. At 7 a.m., the utility continues operating those same units to meet its system load and, therefore, its avoided costs are still only 2.345¢. By 11 a.m., however, as more demand is put on the system, the utility may be required to turn on its next most expensive units whose energy costs are, say, 3.567¢ per kwh.[10] By early afternoon, when the utility's system is running at peak load, the utility may have to use its peakers at an energy cost of, say, 6.789¢ per kwh. Under the Commission's rules, absent agreement or commitment, the new qualifying facility receives a purchase rate based upon the utility's avoided costs at the time the power is delivered. It is only when the utility is operating its most expensive units that a purchase rate based on those high energy costs is required. By the evening, the utility no longer requires its peakers, and the purchase rate drops back to 3.567¢ for power delivered during that period. By the early morning hours, when the utility only operates its base load units, the qualifying facility delivering power is again entitled to a purchase rate of only 2.345¢.[11]

Many utilities do not rely upon their existing facilities to meet all peak system loads. In some cases, the utility contracts with a second utility to purchase bulk power from the second utility. The FERC rules contemplate that if the utility can avoid making such a contract and, instead, obtain that power from a

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10 As the Commission observed, "[u]nder the principle of economic dispatch, utilities generally turn on last and turn off first their operating units with the highest running cost." B-44.

11 While minute-by-minute detailed calculations can be made, they are not practicable. State regulatory commissions have, therefore, implemented the FERC rules by providing for an average daily and seasonal rate which often reflects less than the utility's actual energy cost. As the Commission observed, "the more precisely the time of purchase is recorded the more exact the calculation of the avoided costs, and thus the rate for purchases, can be. Rather than specifying that exact time-of-day or seasonal rates for purchases are required, however, the Commission believes that the selection of a methodology is best left to the State regulatory authorities . . . charged with the implementation of these provisions." B-78, 79.

qualifying facility, those avoided costs—the costs it will not pay the second utility—be calculated in the purchase rate. B-80.

In other cases, a utility cannot meet its projected load requirements, either from its own facilities or by bulk power arrangements with another utility. In those cases, the utility must consider constructing new facilities. Such facilities take years of planning and construction before they are on-line. The FERC rules contemplate that if the qualifying facility makes available power which will obviate the need for the utility to build a new unit, or will permit the utility to build a smaller, less expensive plant, the qualifying facility is entitled to those avoided costs by including capacity costs in the purchase rate. B-44. Moreover, the rules provide utilities with an incentive to contemplate less expensive expansion plans in order to reduce capacity payments to qualifying facilities. The utilities' ratepayers are the beneficiaries of this lower cost.[12]

Before the utility is required to include a capacity factor in its avoided costs, however, the new qualifying facility must assure the utility that it will have that power available when the utility requires it. As a practical matter, the utility is assured of that power by contractually committing the qualifying facility to have it available in the future. Another factor to be taken into account in determining avoided costs under the rules, therefore, is "[t]he terms of any contract or other legally enforceable obligation, including the duration of the obligation, termination notice requirement and sanctions for noncompliance." 18 C.F.R. § 292.304(e)(2)(iii). Absent assurances from qualifying facilities that the power will be available, the utility is not able to avoid the costs connected with construct-

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12 The capacity factor is not based upon a utility's grandiose expansion plans, but rather on "the utility's optimal capacity expansion plan," B-45, which FERC defined as "the schedule for the addition of new generating and transmission facilities which, based on an examination of capital, fuel, operating and maintenance costs, will meet a utility's projected load requirements at the lowest total cost." B-45 n.6.

ing a new plant. FERC's rules do not require inclusion of capacity costs in the purchase rate in these circumstances.[13]

In effect, therefore, rather than utilities always paying at the highest cost as respondents suggest, the full avoided costs purchase rate requires maximum payments only if in fact the utility can avoid both energy and capacity costs in reliance upon the power made available by the new qualifying facility.[14] Thus, the rule carries out the Congressional directive to encourage construction of cogeneration and small power production facilities, while at the same time preventing the utilities' ratepayers from paying any more than they would have paid in the absence of such facilities.

We are at a loss to comprehend respondents' assertion (Res. Br., p. 33) that "FERC's rule deprives utility consumers of benefits they would have reaped but for PURPA." It is premised on the non sequitur that absent the encouragement of new facilities by PURPA and the rules, they would have been constructed anyway and utilities would have purchased their power at lower rates. It was precisely because alternative energy sources were being discouraged by utilities that PURPA was enacted. *See FERC* v. *Mississippi*, *supra*, 102 S. Ct. 2126

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13 As we pointed out in our principal brief (pp. 25-29), the operation of the rule encourages utilities and project developers to negotiate arrangements both to assure the utilities that the power will be available and to assure the developers that the project financing will be available based on a predictable price for the power when produced.

14 If the operation of the rules proves to be inappropriate—creating what respondents and EEI categorize as a "windfall" (Res. Br., p. 18; EEI Br., p. 29)—Congress contemplated that they would be revised periodically by FERC. In the interim, the rules authorize state regulatory commissions to apply for exemptions from the avoided costs formula. 18 C.F.R. § 292.403. Experience to date indicates, however, that the rule has operated as intended by Congress. Indeed, EEI notes the increase in filings by potential cogenerators in the last year. (EEI Br., p. 24 n.18.) The only parties objecting to the purchase rate are the utilities and their association. Not a single state regulatory commission nor consumer group has challenged the avoided costs purchase rate.

(June 1, 1982). In fact, many utilities have been less than cooperative before state regulatory commissions seeking to implement the rules.[15] Some commissions have found it necessary to assess penalties against utilities which have refused to deal with cogenerators.[16]

In the long run, the effect of the rule will be to reduce utilities' avoided costs as more qualifying facilities are constructed. If a utility can meet its requirements for power from new qualifying facilities, it need not utilize expensive peakers or purchase bulk power from other utilities, nor need it construct new plants to satisfy future load growth. As more qualifying facilities are constructed, they will furnish more power to the utilities, thereby reducing the utilities' avoided costs and, in turn, reducing the ratepayers' cost.[17] This long-term benefit is in addition to the other economic and environmental benefits contemplated by Congress and described at

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15 *See, e.g.*, Idaho Public Utilities Comm'n Order No. 17796, Dec. 30, 1982, at 12. ("The evidence is overwhelming that Idaho Power has not processed the Koyle [small power sales] application in good faith and that its failure to do so is symptomatic of a broader failure to implement this entire program in good faith.")

16 *See, e.g.*, California Public Utilities Comm'n Decision No. 91107, December 19, 1979, 34 PUR 4th 1, 114. ("[W]e have found PG&E's efforts to promote the development of cogeneration to have been seriously inadequate. Upon this basis we have concluded that PG&E's authorized return on equity for its electric department operations should be reduced by 20 basis points"—which amounted to $7.2 million); *see, also*, Decision and Order of Maine Public Utilities Comm'n Docket Nos. 81-127, 81-206, March 27, 1982, at 15-16. ("If it were not for [Central Maine Power's] practices with respect to cogeneration and conservation, we would allow CMP a rate increase designed to provide it with a reasonable opportunity to earn a return of 15.5% on its common equity. However, for the reasons set forth below . . . we will allow CMP a rate increase designed to provide it with a reasonable opportunity to earn a return of 15.4% on common equity.")

17 The rules contemplate this reduction in avoided costs by requiring that "[t]he individual and aggregate value of energy and capacity from qualifying facilities on the electric utility's system" be taken into account in calculating avoided costs. 18 C.F.R. § 292.304(e)(2)(vi).

pages 18-20 in our principal brief and in the brief of *amici curiae* National Resources Defense Council, Inc., National Audubon Society and The Solar Lobby.

In short, by encouraging alternative energy sources, the avoided costs purchase rate rule is just and reasonable to the electric consumers of the electric utility, in the public interest and non-discriminatory to qualifying facilities, precisely as PURPA Section 210(b) required.[18]

II.

THE INTERCONNECTION RULE IS LAWFUL

a. Under Federal Power Act Section 210(a)(1), 16 U.S.C. § 824i(a)(1), "any electric utility, Federal power marketing agency, qualifying cogenerator, or qualifying small power producer," may apply to FERC for an order respecting physical connections in various respects.[19] In response, FERC may issue an order requiring "the physical connection of any cogeneration facility, any small power production facility, or the transmission facilities of any electric utility, with the facilities of such applicant." 16 U.S.C. § 824i(a)(1)(A).[20]

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18 API members purchase vastly more electricity than they sell and are vitally interested in this program as ratepayers. The utilities, on the other hand, are interested in their own construction programs which will add to their rate base and hence to their return on investment. It is therefore in their economic interest to discourage cogeneration and small power production by assuring that the purchase rate received is too low to encourage their development.

19 The application may also be made by any "State regulatory authority," 16 U.S.C. § 824i(a)(2), and an order may be entered on the Commission's "own motion." 16 U.S.C. § 824i(d). The order may deal with a physical connection which "is ineffective for any reason, such as inadequate size, poor maintenance, or physical unreliability," 16 U.S.C. § 824i(a)(1)(B), may require "sale or exchange of electric energy or other coordination," *id.* at (C), and may even require an "increase in transmission capacity," *id.* at (D).

20 The order thus may be directed to any cogeneration or small power production facility (whether or not it is a qualifying facility). Under

A qualifying cogenerator or small power producer applying for interconnection with a utility under FPA Section 210, as the Court of Appeals said it must, would be faced with the claim that the connection can only be ordered with the "transmission facilities" of the utility, not its "distribution facilities." The difference between transmission and distribution facilities is an integral part of the Federal Power Act. Indeed, under the Act, there is a jurisdictional distinction between transmission facilities and "facilities used in local distribution." 16 U.S.C. § 824(b).

Respondents and their amicus EEI obfuscate this distinction, asserting that the interconnections at issue here relate to "those necessary to permit cogenerators to *transmit power to* an electric utility." (Res. Br., p. 42; emphasis in original.) Such interconnections, they claim, are therefore with the transmission facilities of the utility. (Res. Br., p. 42; EEI Br., p. 11.) By this logic, the lines over which a utility furnishes electricity to its customers are also transmission facilities. Such lines, however, clearly constitute distribution facilities. As this Court observed in *Connecticut Light & Power Co.* v. *Federal Power Commission*, 324 U.S. 515, 529 (1945):

> "Every facility from generator to the appliance for consumption may thus be called one for transmitting such interstate power. By this test the cord from a light plug to a toaster on the breakfast table is a facility for transmission of interstate energy if any part of the load is generated without the state."

PURPA Section 210(e)(3)(3), "[n]o qualifying small power production *facility* or qualifying cogeneration *facility* may be exempted" from FPA Sections 210, 211 or 212 (emphasis added). A literal reading of the statutes indicates that the FERC interconnection rule does not "exempt" a qualifying facility since the applicant is not the "facility" but, rather, the "cogenerator" or the "small power producer." Respondents denigrate the target/applicant distinction as an "artificial distinction" (Res. Br., p. 46), yet the statute itself recognizes it. Literally, the cogenerator or small power producer is the applicant, while the facility is the target.

Hence, to interpret "transmission" to be the equivalent of "sending," as respondents do, misreads the statute.[21]

b. Respondents' argument ignores one of the fundamental purposes of PURPA Section 210. Not only were FERC's rules to require utilities to offer to purchase electricity from qualifying facilities, as Section 210(a)(2) mandates, but they were also to require utilities to offer to sell electricity to them, as Section 210(a)(1) directs. Both respondents and EEI acknowledge that in order to effectuate sales, an interconnection is required, and concede that the facilities over which electricity is sold to cogenerators and small power producers are distribution and not transmission facilities. (Res. Br., p. 42; EEI Br., p. 11.)

Under PURPA Section 210(a)(1), a utility must offer to sell to qualifying facilities, and it is common ground that such sales require an interconnection. The Court of Appeals' opinion and respondents' argument require the Court to conclude that Congress provided no mechanism by which the Commission can order a utility to interconnect to permit those sales to take place. This result flows from respondents' argument that FERC cannot order interconnection by rule under PURPA Section 210, but must proceed only under the substantive and procedural requirements of FPA Sections 210 and 212. Those sections, however, provide that FERC can only order interconnection with the transmission facilities of electric utilities, not their distribution facilities. Hence, the argument leads to the conclusion that interconnection for sales by utilities cannot be ordered by FERC under PURPA. Not even the utilities have urged that construction of the statute, however, since it so obviously flies in the face of Congressional intention.

The interconnection over which a utility sells electricity to a qualifying facility is the same interconnection over which a utility purchases electricity from a qualifying facility. There is

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21 The discrete purposes behind the FPA amendments and PURPA Section 210 are discussed in the Commission's principal brief (pp. 36-41) and its reply brief and will not be repeated here.

no need for separate interconnections to be constructed and, in fact, they are not. Unless Congress intended PURPA Section 210(a)(1) to have no meaning at all, the Commission's rules must enable FERC to order a utility to interconnect to make sales to qualifying facilities. That same interconnection permits the qualifying facility to sell power to the utility. It is illogical to assume that Congress granted FERC authority to order interconnections for purposes of sales from utilities to qualifying facilities but withheld such authority for purposes of purchases by utilities from qualifying facilities. Such a dichotomy could not have been intended.[22]

c. Respondents and EEI also attempt to support the Court of Appeals' decision by referring to safety and reliability concerns. (Res. Br., p. 43; EEI Br., pp. 13-15.) Indeed, EEI suggests that the very purpose of proceedings under FPA Sections 210 and 212 is to protect the safety and reliability of the utility's system. (EEI Br., p. 13.) Such concerns are of such great moment, it asserts, that Congress placed the responsibility directly with the Commission. (EEI Br., p. 14.) But, later, EEI suggests that proceedings can be streamlined by the Commission which can "dispense with a hearing when no material facts are in dispute." (EEI Br., p. 16.) If no material facts are in dispute, a utility would have no reason to refuse to interconnect with a qualifying facility other than to create the obstacles and impediments to the program which Congress sought to avoid.[23]

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22 Presumably, the utilities would argue that there was no need to compel utilities to interconnect in order to sell to qualifying facilities and therefore Congress never considered the issue. But the legislative history belies that assertion. *See*, *FERC* v. *Mississippi*, *supra*, 102 S. Ct. at 2132, "traditional electricity utilities were reluctant to . . . sell power to, the nontraditional facilities."

23 If safety and reliability are concerns of the utilities, it takes little ingenuity to generate a factual dispute on a material issue requiring full-scale adjudicatory hearings under FPA Section 210. Thus, EEI's attempt (EEI Br., p. 17) to denigrate the concern expressed in our principal brief, that absent the interconnection rule, utilities will continue to impede development of this program, is wide of the mark.

EEI also claims that state regulatory commissions are under no mandate to protect utility systems' safety and reliability. It asserts that fewer than half of the authorities have addressed those concerns when implementing the rules. (EEI Br., p. 15.) This is disingenuous. EEI quotes a portion of the FERC rule authorizing state regulatory authorities to establish reasonable standards to assure system safety and reliability, but neglects to point out that the rule provides that those standards "may be recommended by any electric utility, any qualifying facility, or any other person." 18 C.F.R. § 292.308. To the extent state commissions have not "chosen to address these concerns," as EEI puts it (EEI Br., p. 15), the utilities obviously have not chosen to recommend any particular standards.

Indeed, respondents concede that the technical issues involved in interconnection between utilities and qualifying facilities are "generally less complex than when interconnections among utilities are in dispute." (Res. Br., p. 48 n.66.) The reason is obvious. A qualifying facility seeking to sell its power to a utility transmits that power over the same lines as carry the power the utility sells to it. System safety and reliability are of no greater concern because of the direction in which the current flows.[24]

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24 Cogenerators also have system safety and reliability concerns when interconnected with a utility. A sudden surge from a utility's system into the cogenerator's plant could be far more devastating to the cogenerator than a surge from the cogenerator into the utility's system would be to the utility.

CONCLUSION

For the foregoing reasons, and the reasons stated in our principal brief, the decision of the Court of Appeals should be reversed and the FERC rules upheld.

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In the Supreme Court of the United States

OCTOBER TERM, 1982

AMERICAN PAPER INSTITUTE, INC., PETITIONER

v.

AMERICAN ELECTRIC POWER SERVICE CORP., ET AL.

FEDERAL ENERGY REGULATORY COMMISSION, PETITIONER

v.

AMERICAN ELECTRIC POWER SERVICE CORP., ET AL.

ON WRIT OF CERTIORARI TO THE
UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

REPLY BRIEF FOR THE FEDERAL ENERGY REGULATORY COMMISSION

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REPLY BRIEF FOR THE FEDERAL ENERGY REGULATORY COMMISSION

I. FULL AVOIDED COST

A. Respondents assert (Br. 8-12) that the Commission, when it provided by rule that electric utilities must pay full avoided cost to qualifying facilities (in the absence of a waiver obtained by a state commission or a lower negotiated rate), ignored and violated the statutory requirement (in PURPA Section 210(b)) that rates "shall be just and reasonable to the electric consumers of the electric utility." This assertion wholly misconceives the meaning of the "just and reasonable to consumers" standard and misrepresents the Commission's decision in this case.

1. Respondents seem to read the "just and reasonable to consumers" standard as requiring that utilities pay qualifying facilities minimum rates consistent with a fair rate of return to those qualifying facilities, thus immediately passing on to utility consumers savings resulting from utility purchases from low-cost qualifying facilities. This reading would, in effect, impose traditional cost-of-service ratemaking concepts on purchases by utilities

from qualifying facilities. Congress, however, made it crystal clear that it did not wish to impose such traditional public utility ratemaking concepts on sales *by* qualifying facilities *to* utilities.[1] (Significantly, traditional cost of service concepts *were* to govern sales *by* utilities *to* qualifying facilities.[2]) The Conference Report stresses that qualifying facilities are not low-risk utilities guaranteed a fair return, but, rather, are enterprises fully at

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[1] The Conference Report states:

> It is not the intention of the conferees that cogenerators and small power producers become subject, by virtue of this ["just and reasonable to the electric consumers of the electric utility"] language, and the rules promulgated under this section, to the type of examination that is traditionally given to electric utility rate applications to determine what is the just and reasonable rate that they should receive for their electric power. The conferees recognize that cogenerators and small power producers are different from electric utilities, not being guaranteed a rate of return on their activities generally or on the activities vis a vis the sale of power to the utility and whose risk in proceeding forward in the cogeneration or small power production enterprise is not guaranteed to be recoverable.
>
> The conferees wish to make clear that cogeneration is to be encouraged under this section and therefore the examination of the level of rates which should apply to the purchase by the utility of the cogenerator's or small power producer's power should not be burdened by the same examination as are utility rate applications, but rather in a less burdensome manner. The establishment of utility type regulation over them would act as a significant disincentive to firms interested in cogeneration and small power production.

H.R. Conf. Rep. No. 95-1750, 95th Cong., 2d Sess. 97-98 (1978) (hereinafter "Conf. Rep."). See also J.A. 10-11.

[2] In its discussion of sales by utilities to qualifying facilities, the Conference Report states: "Here the phrase 'just and reasonable' is intended to refer to traditional utility ratemaking concepts. The conferees do not intend that the cogenerator or small power producer pay any more or any less than is otherwise just and reasonable in terms of the utility receiving the reasonable rate of return for providing services to those kinds of users." Conf. Rep. at 98.

risk when they generate power. Consequently, the Report explicitly states, the "just and reasonable to consumers" standard is not intended to subject the rates of qualifying facilities "to the type of examination that is traditionally given to electric utility rate applications to determine what is the just and reasonable rate." Conf. Rep. at 97. The Report emphasizes that "*cogeneration is to be encouraged under this section*," and that traditional "reasonableness" concepts, rigidly tied to sellers' costs, would be a "significant disincentive to firms interested in cogeneration and small power production." *Id.* at 98 (emphasis added). In sum, it is clear that Congress did not intend, through the "just and reasonable" formula, to provide *immediate* rate-savings for utility consumers by requiring qualifying facilities from the beginning to pass on to such consumers all the benefits of low cost operations.

2. As the Conference Report makes clear, the "just and reasonable to consumers" standard must be understood in the context of *this* statute and *its* overriding purposes. Congress explicitly provided that the interests of utility consumers must be taken into account. It was equally explicit, however, that two other statutory factors —factors that respondents wholly ignore in their brief— must also be taken into account: rates are to be "in the public interest" and "shall not discriminate against" qualifying facilities. Even more important, the "just and reasonable" standard must be evaluated in light of the dominating purpose "that cogeneration is to be encouraged." Conf. Rep. at 98. Congress understood that, in the *long* run, electric utility consumers as well as the public at large would benefit if more low-cost qualifying facilities would come into existence. But to entice them to come into existence, rate structures must be such that, *ex ante*, no unnecessary disincentive is created for enterprises considering entry into this market. The Commission's judgment that, at the outset of this statutory enterprise, consumers should pay exactly what they would have paid in any event—(that is, would have paid in the ab-

sence of new qualifying facilities)—rather than sharing immediately in each cost-saving that any new entrant might be able to produce—is an eminently sensible judgment. It is, furthermore, reasonable and just to consumers precisely because it maximizes incentives for the entry of a large number of qualifying facilities into the relevant market; this is likely, over time, to drive down the utility's avoided costs and lead to lower retail rates for customers.[3] In sum, what the Commission concluded was that long-run savings to consumers could be provided by a rule that was consistent with the statute's fundamental purpose of conserving scarce energy resources by encouraging cogeneration and small power production, whereas a rule that insisted on immediate reductions for utility consumers would, in effect, endanger the goose that was promising to lay the golden egg.

3. Respondents assert (Br. 11) that the Commission's "full avoided cost" rule reduces the "just and reasonable" standard to "surplusage," as if the rule were somehow arrived at wholly independently of notions of reasonableness. This is an artificial reading of the record as a whole. The Commission Staff Paper leading to the proposed rules explicitly stated (J.A. 30 n.11):

> [W]e think that so long as the service being offered by a [Qualifying Facility] is fully comparable to the alternative, the payment to the cogenerator of the full cost of the alternative would be just and reasonable to the utility's customers. * * * We do *not* understand the prescription [in the Conference Report] that the proper price is the lower of the just

[3] The Commission's rules provide for periodic adjustments by utilities of the data on which avoided costs may be derived. 18 C.F.R. 292.302(b). In addition, the rules provide that "the individual and aggregate value of energy and capacity from qualifying facilities on the electric utility's system" shall be taken into account in determining avoided costs. 18 C.F.R. 292.304(e)(2)(vi). Under the rules, actual adjustments in the full avoided cost rate are left to state regulatory authorities, who are charged with implementing the Commission's rules (see 16 U.S.C. (Supp. V) 824a-3(f); 18 C.F.R. 292.401(a)), or to the parties themselves through negotiation (see 18 C.F.R. 292.301(b)).

> and reasonable price and the avoided cost as requiring that the selling QF be restricted to a minimal mark-up from its marginal generation cost on its sales to a utility.

The Commission's careful evaluation of all the relevant factors (Pet. App. B-63 to B-66) evidently reflects its own conclusion that a full avoided cost rate would, under all the circumstances, be "just and reasonable" to consumers, as well as being "in the public interest" and otherwise serving the statutory purposes.

Respondents stress (Br. 9, 10-11) that the Conference Report states that purchase rate should be "the lower of" full avoided costs and a rate that satisfies the three-pronged statutory standard (including "just and reasonable to consumers"). In this respect that Report simply restates the statutory scheme and adds no new light. When respondents go on, however, to state that the Commission's rule in effect automatically chooses the higher of the two figures whenever these diverge, they show that they suffer from a misunderstanding. Nothing in the statute, nothing in the Report, and certainly nothing in the economics of rate making suggest that a statutory "just and reasonable" rate will always be at or below the full avoided cost of the *buying* entity. In the absence of the full avoided cost maximum, it would be quite possible and reasonable for the Commission to conclude that under some circumstances a rate *exceeding* full avoided cost would in fact be just and reasonable and in the public interest. It is in such a situation that the statutory maximum would cut in independently to set a ceiling on the Commission's authority.

B. Respondents repeatedly assert (Br. 12-18, 21-22, 25, 28) that the Commission failed to explain its rule and failed adequately to consider alternatives. Specifically, they fault the Commission for not taking into account production costs incurred by qualifying facilities (sometimes labeled "generic" costs). In this they echo the court of appeals' complaint that the Commission adopted a "simplistic and uniform conclusion that the full avoided cost

standard would be just and reasonable in every case" (Pet. App. B-9), and that it relied on a "uniform rule" (*id.* at B-10) rather than a "balancing of the interests" (*ibid.*). These assertions misconceive the regulatory task before the Commission and misrepresent the actual operation of the "full avoided cost" rule.

1. The Commission was faced with the task of creating a start-up regime for a new statutory enterprise, the central purpose of which was to encourage cogenerators and small power producers to enter the business of producing and selling power. It determined (Pet. App. B-65 to B-66) that traditional case-by-case cost of service rate-making would be so burdensome and difficult that, in the words of the Conference Report, it would be a "significant disincentive to firms interested in cogeneration and small power production." Conf. Rep. at 98. It decided, therefore, that—at least as a start-up measure—a general *rule*, rather than case-by-case rate-setting, was called for.

There is, of course, a sense in which *any* across-the-board rate not tied to individual costs is "arbitrary"; it *may*, in a given case, result in a windfall profit to a given low-cost producer—just as it may, in another case, exclude from the market a given high-cost producer. That sort of "arbitrariness" is simply a concomitant of the fundamental decision that an across-the-board general rate (rather than case-by-case rate adjudications based on seller costs) will best achieve the statutory purpose.

It should be noted, moreover, that the dangers of rigidity created by this form of regulation are significantly alleviated here by three major sorts of flexibility built into the Commission's rules:

(a) First, the full avoided cost rule applies only to purchases from "new capacity," *i.e.*, qualifying facilities whose construction was commenced after the enactment of PURPA. 18 C.F.R. 292.304(a)(1), (2). With respect to facilities that were in place or under construction before the passage of PURPA, rates may be set, on a flexible basis, at less than full avoided cost if it is

determined that a lower rate satisfies the statutory criteria and is sufficient to encourage cogeneration and small power production. *Id.* at 292.304(b)(3). The distinction reflects the Commission's sensitive appraisal of all relevant factors. Pre-existing cogenerators by definition do not need a PURPA rate to enter the market; and their costs are known and can more easily be taken into account in arriving at a reasonable rate. See Pet. App. B-67; J.A. 39. In the case of new capacity there is no history of costs, and an across-the-board rate not pitched to historical costs therefore makes most sense; such a solution is also consistent with the central purpose of PURPA to attract new entrants into the business of cogeneration and small power production.[4]

(b) The Commission carefully provided that state commissions are free to seek waivers of the full avoided cost rule. Respondents seek to minimize the impact of this provision (Br. 31-32); they ignore the fact that it is, precisely, state commissions (and not electric utilities) that naturally represent the interests of consumers.[5] If, over time, the operations of the full avoided cost rule come to result in some cases in unjustified exactions from consumers, or unjustified windfalls to a qualifying facility, the

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[4] Amicus curiae Edison Electric Institute (EEI) interprets the fact that applications for qualifying status have increased in number since the time of the court of appeals' decision as demonstrating that a full avoided cost rate is unnecessary to encourage cogeneration (EEI Br. 24). In fact the court of appeals stayed its mandate pending review in this Court, and the Commission's full avoided cost rule has continued in effect.

[5] It should be kept in mind that respondents and EEI (an investor-owned utility trade association) do not, in any sense, truly represent consumer interests. In fact, investor-owned utilities are in direct competition with cogenerators and small power producers as suppliers of electric power. If the cogeneration program is successful, utilities will build fewer generating plants of their own and will be prevented from adding to their own rate base (and, consequently, to their return on investment). Thus, it is in the interest of these utilities to discourage cogeneration and small power production. This is, of course, why PURPA was enacted.

waiver provision can be expected to come more and more fully into play.[6]

(c) Most significantly, as explained in our principal brief (at 22-23), the full avoided cost rule does not in fact require utilities to pay full avoided cost. It requires that they do so *in the absence of a negotiated lower rate.*[7] Given the overwhelming monopsony bargaining power of utilities—the very power that created the need for PURPA—it defies belief to assert that this permission to negotiate a rate below full avoided cost "is of limited practical benefit" (Resp. Br. 32).[8] In fact, in an important sense, the Commission's rules may in practice come to replicate the scheme of the statute itself, which explicitly allows the full avoided rate to serve as a *maximum.* Under the rules, too, that rate will operate as a ceiling, to be charged in the absence of a lower rate freely negotiated by the parties (or obtained by a state commission through a waiver). Sufficient flexibility is thus built into the system to alleviate the fear that long-term arbitrary rigidities will develop and that windfalls to qualifying facilities will result.

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[6] The fact that no waivers have so far been sought (see Resp. Br. 31) simply means that at this time state commissions agree with the Commission that a full avoided cost rate is needed to encourage this fledgling industry.

[7] Respondents suggest (Br. 32) that the right to negotiate a lower rate is irrelevant because "the question is whether rates *under the rule* are 'just and reasonable' to utility ratepayers" (emphasis in original). Respondents fail to comprehend that, while one section of the rule provides for a full avoided cost rate (18 C.F.R. 292.304), another section of the rule provides for negotiated contracts in lieu of that rate (18 C.F.R. 292.301). Thus both provisions are "under the rule" and are designed to operate in tandem.

[8] EEI itself adverts (Br. 24) to the fact that Southern California Edison Company has signed more than 60 contracts with cogenerators since the Commission's rules were enacted, and that most of them are at a rate below full avoided cost. This supports the Commission's conclusion that the full avoided cost rate merely serves as a context for bargaining (Pet. App. B-48 to B-49).

2. Given these flexibilities, complaints about the Commission's decision to initiate the regulatory scheme through an across-the board rate, rather than a method pitched to specific inquiries into specific costs, loses all plausibility. The question that does remain is whether the Commission adequately justified its judgment that that across-the-board rate should be the full avoided cost of the utility. Respondents assert that the Commission did not "explain" why it rejected a lower across-the-board rate, one set at some fixed percentage of avoided cost.[9] In fact, the Commission's explanation is clear and compelling. The Commission's central task of "encouraging" cogeneration and small power production had to be undertaken *ex ante*, in a world of uncertainties. The Commission had to set an "encouraging" rate all at once for thousands of highly various potential producers, many of them small enterprises for whom the question whether or not to enter the electric market would be marginal at best. The full avoided cost rule was plainly promulgated on the basis of a legitimate predictive judgment that, in this world of uncertainties at the start-up of this important legislative enterprise, a ceiling set at a lower rate might gratuitously discourage cogeneration and small power production, and might do so without obtaining significant countervailing benefits.[10] One cannot be certain that that

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[9] The further alternatives suggested by Respondents (Br. 14 n.10) merely constitute variations on the same themes. Setting rates on a "technology by technology" basis would require exactly the sort of painstaking inquiry into the actual and projected costs of innumerable sorts and sizes of possible cogenerators and small power producers that Congress sought to avoid; it would constitute cost-of-service ratemaking under another name. "[G]iving the state commissions a permisaible range of percentages" (*ibid.*) would simply pass through to those state commissions the requirement of imposing cost-of-service ratemaking on qualifying facilities; the left hand would then be undertaking the very task that, by hypothesis, has been deemed inappropriate for the right.

[10] Respondents' discussion (Br. 16) of potential savings is flawed by their significant overestimation of the extent cogeneration facilities are likely to be constructed in the next fifteen years—

judgment will stand the test of time (and that is why it must be seen as an experimental start-up rule to be re-evaluated in light of experience). On the other hand, any other rate—whether 80% or 90% or some other figure—would be subject to the same uncertainty.[11] Indeed, it is striking that the court of appeals' and respondents' criticisms of the full avoided cost rate could be replicated verbatim in the context of an 80% to 90% rate simply by changing the relevant figure that has supposedly not been adequately "explained." In fact, this case shows the extent to which that charge—"inadequate explanation"—has become a convenient surrogate for attacks on agencies' legitimate substantive judgments by private parties and courts eager to substitute for these judgments their own views of what is wise policy.

In sum, the full avoided cost rule maximizes the central statutory purpose to encourage cogeneration and small power production. It does so without a penny of

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particularly if rates are generally set below full avoided cost. The Commission has estimated that by 1995, the amount of new cogeneration capacity likely to be induced from a full avoided cost rate is approximately 12,000 MW (Pet. App. B-139). This compares with the utilities' planned resources to meet expected demand of 807,906 MW by 1995. See *Report of North American Electric Reliability Council, Electric Power Supply and Demand: 1982-1991* 34 (Table 13) (1982). Thus, new cogeneration may amount to less than 2% of the nation's total estimated electric generating capacity by 1995. A rule setting purchase rates at 95% (rather than 100%) of avoided cost would thus generate savings of only one-tenth of one percent.

[11] It must always be remembered that the Commission's task was to set a rate whose purpose was to attract thousands of highly variegated new firms into a difficult market—one that the utilities had, until the passage of PURPA, managed successfully to stifle—before a history of costs had been generated. In these circumstances, there is a sense in which "empirical evidence" to determine whether 80% or 90% or 100% is, in the abstract, the "correct" figure, does not exist. As the Commission's staff paper noted (J.A. 30 n.11), "we have difficulty in describing some particular price other than the avoided cost as being just and reasonable to the utility's customers * * *."

extra cost to consumers, who pay no more than what they would have in the absence of PURPA and the PURPA rate. And it secures for consumers and the country at large the principal benefit Congress sought to provide—the entry of new firms into the business of cogeneration and small power production.

II. INTERCONNECTION

A. Respondents' contention that Section 210 of the Federal Power Act (FPA) provides the exclusive means for ordering utilities to interconnect with qualifying facilities ignores the fundamentally different objectives of the two statutes. Section 210 of PURPA encourages the development of alternative energy sources. Section 210 of FPA seeks greater coordination among and reliability in the nation's bulk power transmission systems. Respondents, misreading the legislative history, confound these objectives. Their arguments, if accepted, would thwart the congressional purpose underlying Section 210 of PURPA.

1. Although FPA Section 210(a)(1) authorizes the Commission to order a utility to interconnect with a qualifying facility upon the latter's application, nothing in the statute indicates that the Commission may not also use its authority under Section 210(a) of PURPA to order interconnections necessary to facilitate the purchases and sales that the Commission is directed to encourage under the latter statute. Indeed, Section 212(e) of the Power Act, 16 U.S.C. (Supp. V) 824k(e) (emphasis added), which was enacted together with FPA Section 210, contains a savings clause that provides:

> (e) No provision of section [210] or [211] of this title shall be treated—
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> (1) as requiring any person to utilize the authority of such section [210] or [211] of this title in lieu of *any other authority of law*, or
>
> (2) as limiting, impairing, or otherwise affecting any authority of the Commission under *any other provision of law*.

As the Commission correctly observed (Pet. App. B-60), FPA Section 212(e) "refutes the contention that section 210 of the Federal Power Act represents the exclusive method by which interconnection can be obtained." [12]

2. Respondents place heavy reliance (Br. 38-39) on certain statements in the legislative record by Administration spokesman David J. Bardin concerning the interconnection and cogeneration provisions of the Administration's proposed bill, S. 1469 (Part E) and H.R. 6831, 95th Cong., 1st Sess. (1977). Section 521 of that bill would have empowered the Commission to order a utility to interconnect with a qualifying cogenerator on the latter's application. Under Section 522, the Federal Energy Administration would have been authorized to issue rules regarding purchases and sales between utilities and qualifying cogenerators. Respondents assert that this division of regulatory authority reflects Congress' intent that the sole authority to order interconnections necessary to promote cogeneration would be contained in the interconnection provision, and not in the cogeneration provision, of the statute that ultimately was enacted.

The short answer to this argument is that the structure of the Administration bill was not carried forward in either the House or Senate bills, and it was from these

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[12] Respondents contend (Br. 45 n.61) that the Commission's view of the savings provision is at odds with a statement in the Conference Report that FPA Section 212(e) expresses the intention that "the authorities granted in [FPA] sections 210 and 211 are in addition to and not in lieu of other authority the Commission may have *under the Federal Power Act*." Conf. Rep. at 94 (emphasis added). The conferees' passing reference to the Commission's "Power Act" authority should not override the unambiguous reference in the savings clause to "any" other provision of law. In any event, the same report shows that the Committee did not draw fine distinctions between PURPA and the Power Act. Thus, a few pages earlier in the same report, the conferees refer to exemptions "under section 210(e) of the Federal Power Act" (Conf. Rep. at 39). This is clearly a reference to Section 210(e) of PURPA. In fact, the two statutes are inextricably intertwined. For example, the definitions of qualifying small power production facility and cogeneration facility applicable to Section 210 of PURPA are contained in Section 3 of the Power Act, 16 U.S.C. (Supp. V) 796(17), (18).

later bills, not the Administration proposal, that the conference agreement evolved. (See App., *infra*, 1a-14a, for the pertinent provisions of these bills.) Both the House and Senate bills contained interconnection provisions that would have empowered the Commission to order electric utilities (broadly defined to include otherwise nonjurisdictional utilities) to interconnect and coordinate with other utilities or with qualifying facilities. H.R. 8444, § 541(b), 95th Cong., 1st Sess. (1977); Senate amendment to H.R. 4018, § 122(a), 95th Cong., 1st Sess. (1977). Further, as noted in our opening brief (at 43), the cogeneration section of the House bill contained its own interconnection provision. H.R. 8444, § 546. The cogeneration section of the Senate bill (Senate amendment to H.R. 4018, § 113(a)), on the other hand, made no reference to interconnections—a natural omission, since that section would only have authorized the Secretary of Energy to *recommend* to state regulatory authorities the adoption of guidelines concerning cogeneration. Thus, Mr. Bardin's comments, relating to the unreported and unenacted Administration bill—comments that, in context, in any event do not support respondents' position [13] —cannot control the interpretation of the statutes as ultimately enacted. See *Red Lion Broadcasting Co.* v. *FCC*, 395 U.S. 367, 382 n.11 (1969); *Hardin* v. *Kentucky Utilities Co.*, 390 U.S. 1, 11 (1968).[14]

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[13] When viewed in proper perspective, Mr. Bardin's statements demonstrate that the Administration viewed bulk power transmission problems, necessitating new Commission interconnection authority, as distinct from the barriers hindering the development of cogeneration. See S. Rep. No. 95-442, 95th Cong., 1st Sess. 32-33 (1977); *Public Utility Rate Proposals of President Carter's Energy Program: Hearings on S. 122, S. 1300, S. 1363, S. 1469 (Part E) Before the Subcomm. on Energy Conservation and Regulation of the Senate Comm. on Energy and Natural Resources*, 95th Cong., 1st Sess. (Pt. 1) 187-192 (1977); *National Energy Act: Hearings on H.R. 6831, et al. Before the Subcomm. on Energy and Power of the House Comm. on Interstate and Foreign Commerce*, 95th Cong., 1st Sess. (Pt. 3) 89-94 (1977).

[14] Respondents' reliance (Br. 39-40) on an analysis of the Administration bill prepared by the Congressional Office of Technology

3. Contrary to respondents' arguments (Br. 41-43), the changes in the legislation that were made in conference undermine, rather than support, respondents' position.

a. First and foremost, respondents' assertion, that the Commission must hold a full adjudicative "public interest" hearing under FPA Section 210 before ordering an interconnection in every case in which a qualifying cogenerator or small power producer seeks to hook up with a utility for purposes of making purchases and sales pursuant to PURPA Section 210, rests on a wholly distorted understanding of the latter provision. Section 210 of PURPA was the product of a compromise between two quite different legislative approaches. Under the House bill, state regulatory authorities would have been permitted, but not required, to enforce the Commission's rules concerning cogeneration; if the state authorities chose not to do so, the regulatory burden would have been borne directly by the federal government. See H.R. Rep. No. 95-496 (Pt. 4), 95th Cong., 1st Sess. 157 (1977). In contrast, under the Senate version, the federal role in promoting cogeneration was limited to recommending that the states adopt guidelines governing purchases and sales between cogeneration facilities and utilities. The Senate approach, fashioned in response to widespread criticism of the House proposal, sought to encourage the development of cogeneration facilities without federal preemption. See S. Rep. No. 95-442, 95th Cong., 1st Sess. 14 (1977).

In Section 210 of PURPA, the conference adopted the House approach requiring promulgation of federal rules, *but retained the Senate approach providing for state*

Assessment is irrelevant for the same reason. Nor does the statement of former Commission Chairman Charles Curtis (Resp. Br. 40-41) support respondents' position. Mr. Curtis' statement cannot be construed as suggesting that Section 541 of H.R. 8444, the interconnection provision of the bill that subsequently passed the House, would have provided the sole authority for the Commission to order utilities to interconnect with qualifying facilities, since, as noted above, Section 546, the cogeneration provision of the same bill, expressly provided for interconnection rules.

implementation of the regulatory program. (It was this requirement of state implementation that was at issue before this Court last Term in *FERC* v. *Mississippi*, 456 U.S. 742 (1982).) This was, in other words, a deliberate policy choice in favor of *decentralized* implementation of the congeneration program at the *state* level. Given this choice, it is inconceivable that Congress, in enacting Section 210 of PURPA in order to encourage cogeneration, would have intended to require owners of qualifying facilities—many of them small operations by definition [15]—to appear at a full evidentiary hearing before the Federal Energy Regulatory Commission in Washington, D.C., every time they wished to obtain an order requiring a utility to interconnect for the purpose of making purchases and sales pursuant to Section 210 of PURPA. Yet this result is the inevitable consequence of respondents' construction of the statute.

b. Respondents point out (Br. 43 n.57) that the Conference Committee deleted, from the cogeneration section of the House bill, the provision directing the Commission to promulgate rules "respecting the interconnection of a qualifying cogeneration facility to the distribution system of any electric utility" (H.R. 8444, § 546(a)(2)). They argue that the deletion suggests that Congress meant to deprive the Commission of authority to issue an interconnection rule under PURPA Section 210(a). But at the same time the conferees deleted this provision, they granted the Commission the authority, in Section 210(a) of PURPA, to prescribe "such rules as it determines necessary to encourage cogeneration and small power production * * *." 16 U.S.C. (Supp. V) 824a-3(a). By directing the Commission to "encourage" cogeneration (a directive that was not included in either the House or Senate bills) and by leaving to the Commission's determination the choice of rules necessary to reach that objective, Congress clearly meant to give the Com-

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[15] See 16 U.S.C. (Supp. V) 796(17)(A)(ii) (defining small power production facility as one with a production capacity of no more than 80 megawatts).

mission broader rather than narrower authority to prescribe rules necessary to carry out the statutory mandate of removing the existing institutional and regulatory impediments to cogeneration and small power production and to promote the development of these technologies.

c. Respondents also contend (Br. 41-43) that, insofar as the Commission retains authority under PURPA Section 210 to order interconnections, that authority is limited to ordering interconnections for purposes of sales by utilities to qualifying facilities only, and not for purposes of purchases by utilities from qualifying facilities. This contention rests on respondents' perceived distinction between the "transmission" and "distribution" facilities of a utility. According to respondents, distribution facilities in this context are used only to send power from a utility to a qualifying facility, whereas transmission facilities are used only to send power from a cogenerator to a utility. Because the deleted provision of the cogeneration section of the House bill referred to interconnections with the "distribution system" of a utility, respondents urge that PURPA Section 210 at most authorizes the Commission to issue rules governing those interconnections necessary to send power from the utility to the cogenerator. On the other hand, in respondents' view, Section 210(a)(1)(A) of the Power Act—which empowers the Commission to order a utility to interconnect its "transmission facilities" with the facilities of a qualifying facility—is the sole authority by which the Commission may order interconnections necessary to send power from the cogenerator to the utility.

Respondents' version of the distinction between "transmission" and "distribution" facilities finds no support in the statute and is contrary to the usage of the industry. Transmission facilities are commonly regarded as including the high voltage transmission grid that connects a utility's generation facilities with its load centers and as not including the low voltage distribution system that is

used to distribute power to end users.[16] Utilities sell power via transmission facilities as well as via distribution facilities.[17] They can buy power via distribution as well as transmission facilities. Thus, the terms "distribution" and "transmission" do not distinguish between the utility as seller or buyer, but between low voltage and high voltage systems. It therefore follows that Section 210 of the Power Act refers to interconnections with the "transmission facilities" (but not the distribution facilities) of utilities precisely because Congress, in that provision, was addressing problems associated with high voltage bulk power transmission and coordination.

If, as respondents assert, FPA Section 210 is the exclusive means by which qualifying cogenerators and small power producers can seek interconnections for the purpose of selling electricity to utilities, there would exist a significant gap in the statute. Although the largest industrial cogenerators (some of them capable of cogenerating more than 1,000 megawatts) could tie into high voltage transmission lines, most qualifying facilities—particularly small power producers—generate much less power and could not economically increase their voltage to connect with these lines. As a practical matter, therefore, qualifying facilities in most cases will have to be connected to the utility's distribution system at distribution voltages for purposes of both selling to and purchasing

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[16] See *Glossary of Important Power and Rate Terms, etc.* (FPC 1965), defining "transmission" as "the movement or transfer of electric energy in bulk. Ordinarily the transmission movement is considered to end when energy is transformed for distribution to ultimate consumers." Bulk power is high voltage power. Thus, "transmission" of power requires high voltage lines. Distribution networks, in contrast, carry low voltage power that can be used by customers. See *Southern California Edison*, 20 F.E.R.C. (CCH) ¶ 61,301 (Sept. 10, 1982). See also generally *Connecticut Light & Power Co.* v. *FPC*, 324 U.S. 515 (1945).

[17] Indeed, the FPA explicitly authorizes the Commission to order utilities to "sell" (as well as exchange) electricity over their "transmission" lines. See 16 U.S.C. 824a(b); 16 U.S.C. (Supp. V) 824i(a)(1)(C).

from the utility. Under respondents' view of the statute, most qualifying facilities would be powerless to obtain an interconnection with a utility for the purpose of selling their surplus power at distribution voltage levels.

B. Respondents argue (Br. 35-37, 43, 45 & n.61) that the Commission's interconnection rule, 18 C.F.R. 292.303(c), constitutes an "exemption" from Section 210 of the Power Act and is therefore prohibited by Section 210(e)(3)(B) of PURPA. The latter section provides that, although the Commission generally may exempt qualifying facilities in whole or in part from the Power Act and from certain other state and federal laws, no qualifying facility "may be exempted" from, *inter alia*, "the provisions of section 210, 211, or 212 of the Federal Power Act or the necessary authorities for enforcement of any such provision under the Federal Power Act." 16 U.S.C. (Supp. V) 824a-3(e)(3)(B).

1. The language of Section 210(e)(3)(B) plainly supports the Commission's view (Pet. App. B-180 to B-182) that it was enacted to preclude the Commission from exempting qualifying facilities as *targets* of interconnection orders, and that the provision has nothing to do with cogenerators as applicants for such orders.[18] "To exempt" is defined as "to relieve, excuse or set free from a duty or service imposed upon the general class to which the individual exempted belongs." *Black's Law Dictionary* 513 (5th ed. 1979). Nothing in the Commission's interconnection rule purports to relieve qualifying facilities from any "duty or service" under Section 210 of the Power Act.[19] Section 210 of the Power Act continues to apply to

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[18] Moreover, the statutory language barring exemptions for qualifying facilities from "the necessary authorities for *enforcement*" of FPA Section 210 makes no sense at all in the context of these facilities as applicants.

[19] Indeed, the section of the Commission's rules that deals with exemptions explicitly states that any qualifying facility "shall be exempt from all sections of the Federal Power Act, except," *inter alia*, "Sections 210, 211 and 212." 18 C.F.R. 292.601(c)(2).

qualifying facilities according to its terms in the same way it would have applied had the Commission not prescribed its interconnection rule under PURPA.[20]

2. The plain reading of the statute is bolstered by the legislative history, which shows that it was not until the interconnection section of the legislation included qualifying facilities as potential *targets* that Congress inserted in the cogeneration section a limitation on the Commission's authority to exempt qualifying facilities from the provisions of the Power Act.

Both the House and Senate bills included qualifying cogenerators and small power producers as potential applicants for orders directing electric utilities to interconnect, but did not include qualifying facilities as possible targets. H.R. 8444, § 541(b); Senate amendment to H.R. 4018, § 122(a). Neither bill contained any limitation on the Commission's authority to exempt qualifying facilities from the provisions of the Federal Power Act. H.R. 8444, § 546(e); Senate amendment to H.R. 4018, § 113(b). The obligation of qualifying facilities to interconnect when ordered to do so was first included in the legislation by the conferees, who, at the same time, included the limitation on the Commission's authority to exempt qualifying facilities from the provisions of the Power Act.

These developments compel the conclusion that when the conferees decided to make qualifying facilities potential *targets* of the Commission's new authority to require coordination of bulk power transmission systems, they ensured that such facilities could not be exempted from these

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[20] Section 210 of PURPA does not require qualifying facilities to sell electricity. It simply requires *utilities* to offer both to sell electricity to, and purchase electricity from, qualifying facilities. Under Section 210(a) of the Power Act, however, the Commission may compel any cogeneration or small power production facility (whether a qualifying facility or not) to sell or exchange energy, even though the facility might prefer to sell to another party or to consume all of its power itself.

new obligations.[21] There is no meaningful evidence that the conferees also intended this limitation on the Commission's exemption authority to be transformed into a crippling encumbrance on the power of the Commission to encourage cogeneration by issuing a rule ordering utilities to interconnect with qualifying facilities.[22]

CONCLUSION

For the foregoing reasons and those presented in our opening brief, it is respectfully submitted that the judgment of the court of appeals should be reversed.

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MARCH 1983

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[21] This is reflected in the language of the pertinent statutory provisions. Section 210(e)(3)(B) of PURPA provides that no qualifying "facility" may be exempted from the provisions of FPA Section 210. The latter section, in turn, provides that any cogeneration or small power production "facility" may be the *target* of an interconnection order. In contrast, FPA Section 210 describes potential *applicants* for interconnection orders as any qualifying "cogenerator" or "small power producer." These terms are not interchangeable. Congress carefully defined each of them separately in Section 3 of FPA, 16 U.S.C. (Supp. V) 796(17), (18).

[22] Respondents and EEI argue that Congress addressed specific safety and reliability concerns in FPA Section 210 and that resort to PURPA Section 210 as authority for a cogeneration interconnection rule improperly circumvents the reliability safeguards contained in FPA Section 210. In Section 210(a) of PURPA, however, Congress specifically directed the Commission to include in its rules provisions regarding reliability. The Commission's rules provide that, on the recommendation of any electric utility, any state regulatory authority "may establish reasonable standards to ensure system safety and reliability of interconnected operations." 18 C.F.R. 292.308.

APPENDIX *

1. **The Administration bill,** S. 1469 (Pt. E) and H.R. 6831, 95th Cong., 1st Sess. (1977), provided in pertinent part:

Interconnection and Wheeling

Sec. 521. (a) Section 202(b) of the Federal Power Act is amended to read as follows:

"(b) (1) Whenever the Commission, on its own motion, or upon application of any State commission or of any electric utility or any qualifying cogenerator (as defined in Section 522(b)(2) of the Public Utility Act of 1977), and after notice to each State commission and electric utility affected and after evidentiary hearing, finds such action necessary or appropriate in the public interest, it shall by order direct an electric utility—

> "(A) to establish physical connection of its transmission facilities with the facilities of any other electric utility or qualifying cogenerator, or
>
> "(B) (i) to sell or deliver energy to, (ii) exchange energy with, (iii) transmit energy for, (iv) provide pooling, wheeling, or other transmission services for, or (v) otherwise coordinate with, such utility or cogenerator.

"(3) The Commission may prescribe the terms and conditions of the arrangement to be made between the persons affected by any order under this subsection, including the apportionment of cost between them and the compensation or reimbursement reasonably due to any of them.

"(4) The Commission shall have no authority under this subsection to compel the enlargement of generating facilities for purposes of this subsection, nor to compel

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* The pertinent provisions of the statute as enacted are set forth in an appendix to our main brief (at 1a-15a).

an electric utility to sell or exchange energy if to do so would unreasonably impair its ability to render adequate service to its customers."

(b)(1) Section 202(a) of the Federal Power Act is amended by striking the word "voluntary" from the first sentence.

(2) The first sentence of section 201(b) is amended by inserting "(other than 202(b))" after "Part" and by adding the following at the end thereof: "The provisions of section 202(b) shall apply to the electric utilities and other persons specified therein."

(3) Section 201(e) is amended by inserting "(other than facilities subject to such jurisdiction solely by reason of section 202(b))" before the period at the end thereof.

Cogeneration

Sec. 522. (a) Not later than one year after the date of enactment of this Act, the Administrator shall, after consultation with representatives of State regulatory authorities, prescribe rules requiring electric utilities to offer to sell electric energy to any qualifying cogenerator and to offer to purchase electric energy from such cogenerators. Such rules shall insure that rates for such sales and purchases do not discriminate against such cogenerators, and may, in order to carry out the purposes of this Act, include provisions exempting qualifying cogenerators in whole or part from the Federal Power Act, the Public Utility Holding Company Act, and from State laws and regulations respecting electric utility regulation, if the Administrator determines such exemption is necessary to carry out the purposes of this part.

(b) For purposes of this section:

(1) The term "cogeneration facility" means a facility owned by a person not primarily engaged in the generation or sale of electric power, which facility produces (A) electric energy and (B) other forms of useful energy (such as steam or heat)

which is, or will be used for industrial, commercial, or space heating purposes.

(2) The term "qualifying cogeneration facility" means a cogeneration facility which the Administrator determines—

(A) meets such requirements (including requirements respecting minimum size, fuel use, and fuel efficiency) as the Administrator, by rule, prescribes; and

(B) the owner or operator of which offered (at such time and in such manner as the Administrator may prescribe by rule) each electric utility to which such facility is, or will be, directly connected an opportunity to operate such facility on terms which are agreed upon by the parties.

(3) The term "qualifying cogenerator" means any person who is, or will be, the owner or operator of a qualifying cogeneration facility.

(c) For purposes of enforcement of this section, a rule under this section shall be treated as a rule under the Federal Power Act; except that, for such purposes, any reference in sections 309, 314, 315 and 316 of the Federal Power Act to the Commission shall be deemed to be a reference to the Administrator.

(d) The Administrator may delegate (on such terms and conditions as he determines appropriate) any part of his authority under this section respecting any electric utility (other than a Federal agency) to any State regulatory authority which he determines has the capability of effectively exercising such authority with respect to such utility.

2. **The Senate bill,** Senate amendment to H.R. 4018, 95th Cong., 1st Sess. (1977), provided in pertinent part:

COGENERATION, BACK-UP POWER, AND SMALL POWER PRODUCERS

SEC. 113. (a) Not later than one year after the date of enactment of this subtitle, the Secretary of Energy shall, after consultation with representatives of State regulatory authorities, electric utilities, cogenerators, and small power producers recommend to the State regulatory authorities guidelines requiring, where he deems appropriate, electric utilities to offer to sell electric energy to any qualifying cogenerator or small power producer and to offer to purchase electric energy from such cogenerators or small power producers. Such recommendations shall include procedures to insure that rates for such sales do not discriminate against such cogenerators or small power producers or against the customers of the utility or utilities. Such guidelines may not require an electric utility to purchase electric energy from a qualifying cogenerator or small power producer during any period at a rate which exceeds the highest incremental cost at which such utility generates electric energy or purchases electric energy from any other source, during such period. Such guidelines shall not authorize any cogeneration facility to make any sale for purposes other than resale.

(b) Not later than one year after the date of enactment of this subtitle, the Secretary of Energy shall, after consultation with representatives of State regulatory authorities, electric utilities, cogenerators, and small power producers, prescribe rules exempting qualifying cogenerators and small power producers in whole or in part from the Federal Power Act and/or the Public Utility Holding Company Act, if the Administrator determines such exemption is necessary to carry out the purposes of this subtitle: Provided, however, That power producers of over thirty megawatts may not be exempt from the Federal Power Act: And provided further,

That a Federal license must still be required under the Federal Power Act, regardless of whatever other exemptions may be granted.

(c) Not later than one year after the date of enactment of this subtitle, the Secretary of Energy shall, after consultation with representatives of State regulatory authorities, electric utilities, and alternative energy industries and consumers, recommend to State regulatory authorities guidelines for the purpose of preventing utilities from engaging in any conduct which results in unreasonable or discriminatory rate or pricing structures or practices against consumers that utilize power facilities or sources other than those provided or otherwise supplied by any such utility including, but not limited to solar, geothermal, photovoltaic, wind, and other power sources as the Secretary may decide.

(d) For the purposes of this section, the term—

(1) "cogeneration facility" means a facility owned by a person not primarily engaged in the generation or sale of electric power (other than in connection with the ownership or operation of cogeneration facilities or small power production facilities), which facility produces (A) electric energy and (B) other forms of useful energy (such as steam or heat) which is or will be used for industrial, commercial, or space heating purposes: Provided, however, That nothing in this section is meant to prevent utilities from producing electricity by cogeneration;

(2) "qualifying cogeneration facility" means a cogeneration facility which the Administrator determines meets such requirements (including requirements respecting minimum size, fuel use, and fuel efficiency) as the Administrator, by rule, prescribes;

(3) "qualifying cogenerator" means any person who is, or will be the owner or operator of a qualifying cogeneration facility;

(4) "small power production facility" means a facility owned by a person not primarily engaged in

the generation or sale of electric power (other than in connection with the ownership or operation of cogeneration facilities or small power production facilities), which facility produces only electric energy by the use of solid waste and/or renewable resources. Such a facility may not be larger than eighty megawatts. Such term includes, but is not limited to—

(A) existing dams not used for electric generation within the past five years;

(B) solar electric systems;

(C) wind systems;

(D) production of electric energy from solid waste;

(E) electric energy storage facilities operated in connection with such a small power production facility; and

(F) production of electric energy from wood;

(5) "qualifying small power production facility" means a small power production facility which the Administrator determines meets such requirements (including requirements respecting fuel use, fuel efficiency, and technical reliability) as the Administrator, by rule, prescribes;

(6) "qualifying small power producer" means any person who is, or will be, the owner or operator of a qualifying small power production facility; and

(7) "incremental cost" of a unit of electricity means the additional cost that would be incurred by a utility if the utility had generated the unit of electricity with its then available generation capacity or capacity available to it.

INTERCONNECTION

SEC. 122. (a) Section 202 of the Federal Power Act is amended by adding a new subsection (g) to read as follows:

"(g) (1) Whenever the Commission, upon application of any State Regulatory Authority or any qualifying cogenerator as defined in the Public Utilities Regulatory Policy Act of 1977 or any electric utility, and after notice to each State regulatory authority, qualifying cogeneration [sic] or electric utility affected and after opportunity for hearing, finds such action necessary or appropriate to carry out the purposes of paragraph 2(a) or 2(b) of the Public Utilities Regulatory Policy Act of 1977, it may by order direct an electric utility (other than a Federal agency), to establish physical connection of its transmission facilities with the facilities of any other electric utility or qualifying cogenerator; and to order such utility or qualifying cogenerator to sell energy to, to exchange with, and otherwise to coordinate with parties only as necessary to effectuate the intent of the interconnection.

"(2) Prior to issuing an order under the authority of this subsection, the Commission shall inform the parties of its intent to issue such order and shall set a reasonable time for the terms and conditions of agreements among the parties affected by such order to be determined by negotiation among said parties: Provided, That said terms and agreements shall be subject to approval by the Commission and in the event that the parties do not reach an agreement approved by the Commission, the Commission may prescribe the terms and conditions of the agreement among the parties affected by such agreement, including the apportionment of cost among them and the compensation or reimbursement reasonably due to any of them: And provided further, That if in the Commission's judgment, time is of the essence, the Commission may issue an order under the authority of this subsection prior to or during the negotiations among the parties.

"(3) The Commission shall have no authority under this subsection to—

"(A) compel the enlargement of generating facilities for purposes of this subsection, or

"(B) take any action that would result in an uncompensated economic loss to the electric utility or its customers, place an undue burden on such utility, unreasonably impair the reliability of the system of any utility, or impair its ability to render adequate service to its customers,

"(4) Except as provided in this subsection, compliance by any electric utility with an order issued under this subsection shall not subject any electric utility to regulation under the Federal Power Act if any such electric utility is not otherwise subject to regulation under such Act.

"(5) For the purposes of this subsection the term 'electric utility' means a utility as defined in the Public Utilities Regulatory Policy Act of 1977 which sells or exchanges electric energy.".

(b)(1) The first sentence of section 201(b) is amended by inserting "other than section 202(g))" after "Part" and by adding the following at the end thereof: "The provisions of section 202(g) shall apply to the electric utilities and other persons specified therein.".

(2) Section 201(e) is amended by inserting "(other than facilities subject to such jurisdiction solely by reason of section 202(g))" before the period at the end thereof.

(c) Upon the effective date of the Department of Energy Organization Act (Public Law 95-91) the authorities vested in the Federal Power Act by this section shall be transferred to and vested in the Federal Energy Regulatory Commission.

3. **The House bill**, H.R. 8444, 95th Cong., 1st Sess. (1977), provided in pertinent part:

INTERCONNECTION, POOLING, WHEELING, AND CENTRAL DISPATCH

SEC. 541. (a) REGIONAL DISTRICTS.—Section 202(a) of the Federal Power Act is amended:

(1) by striking the word "voluntary" from the first sentence; and

(2) by inserting "for the purpose of assuring the goals set forth in this part and to assure maximum competitive opportunities for the purchase and sale of electric energy at wholesale at the lowest possible cost" immediately after "districts" in the third sentence.

(b) Section 202(b) of such Act is amended to read as follows:

"(b) (1) Whenever the Commission, on its own motion or upon application of any State commission or of any electric utility or the owner or operator of any qualifying cogeneration facility (as defined in section 546(b)(2) of the Public Utilities Regulatory Policy Act of 1977), and after public notice and notice to each State commission and electric utility directly affected and after evidentiary hearing, finds it necessary or appropriate in the public interest, it shall by order direct an electric utility to—

"(A) establish physical connection of its transmission facilities with the facilities of any other electric utility or qualifying cogenerator, or

"(B) (i) sell or deliver energy to or exchange energy with,

"(ii) provide pooling for,

"(iii) provide wheeling, or otherwise transmit energy for, or

"(iv) otherwise coordinate with,

such utility or cogenerator. For purposes of this paragraph, the term 'wheeling' means transmission of electric energy among electric utilities and qualifying cogeneration facility [sic] (as defined in section 546(b)(2) of the Public Utilities Regulatory Policy Act of 1977), but such term does not include the transmission of electric energy to an ultimate consumer (other than to a qualifying cogenerator for purposes of providing backup power, as determined by the Commission).

"(2) No order may be issued under subparagraph (A) of paragraph (1) unless the Commission determines that—

> "(A) such order will benefit consumers of an electric utility by reducing costs of supplying electric energy to such consumers or will otherwise provide public benefits in assuring that supplies of electric energy are generally made available with greater economy and with regard to the proper utilization and conservation of natural resources, and
>
> "(B) no utility subject to such order or consumers of such utility will suffer economic hardship thereby.

The Commission may not issue an order under paragraph (1) upon application of any electric utility or the owner or operator of any qualifying cogeneration facility to direct an electric utility to establish physical connection or to provide wheeling services unless the electric utility or qualifying cogeneration facility which makes an application for such connection or wheeling demonstrates to the Commission that such electric utility or owner or operator of any qualifying cogeneration facility is ready, willing, and able to provide reimbursement reasonably due for the costs (including capital and operating costs) incurred by the electric utility or owner which is requested to make physical connection or to wheel electric energy.

"(3) Whenever the Commission, on its own motion or upon application of any electric utility within a regional district established under this Act, and after public notice

and notice to each State commission and electric utility directly affected and after evidentiary hearing, finds such action necessary or appropriate in the public interest it may by order direct any electric utility owning or operating any bulk power transmission facility located (in whole or in part) within such district to increase the transmission capacity of such facility.

"(4)(A) With respect to each regional district established under this Act in which a centrally dispatched power pool in [sic] not operating, upon its own motion or upon application the Commission shall commence a proceeding to determine whether requiring operation of such a power pool in such area is technologically and economically feasible and in the public interest. To the extent that the Commission determines, after public notice and notice to each State commission and after evidentiary hearing, that operation of such a pool is technologically and economically feasible and in the public interest, the Commission shall by order require operation of such a pool.

"(B) For purposes of subparagraph (A), the term 'centrally dispatched power pool' means—

"(i) a power pool which utilizes a central dispatch system for all generation facilities (other than cogeneration facilities which are not required to be included as provided under regulations under section 546(a)(2) of the Public Utilities Regulatory Policy Act of 1977) in a regional district and in which, to the extent technologically and economically feasible as determined by the Commission, each electric utility which owns or operates a bulk power generation facility in such region participates, or

"(ii) an exchange or other system which the Commission determines is more effective or substantially as effective as a power pool referred to in clause (i) in assuring the most economical utilization of generation and transmission facilities in such area.

"(C) For purposes of subparagraph (B), the term 'central dispatch system' means a centrally coordinated

system for controlling the generation and transmission of electric power in an area which system is designed to obtain the most economical utilization of generation and transmission facilities in such area.

"(5) The Commission shall prescribe the terms and conditions of the arrangement to be made between the persons affected by any order under this subsection, including the apportionment of cost between them and the compensation or reimbursement reasonably due to any of them if the parties fail to agree to such terms and conditions.

"(6) The Commission shall have no authority under this subsection to compel the enlargement of generating facilities for purposes of this subsection, nor to compel an electric utility to take any action under paragraph (1) if the Commission determines that to do so would impair the ability of the electric utility to render adequate service to its customers.".

(c) APPLICATION OF FEDERAL POWER ACT.—(1) The first sentence of section 201(b) of such Act is amended by inserting "(other than sections 202(b), relating to interconnection, pooling, wheeling, and central dispatch, and 205(k), relating to unfair competition)" after "Part" and by adding the following at the end thereof: "The provisions of sections 202(b) and 205(k) shall apply to the electric utilities and other persons specified therein.".

(2) Section 201(e) of such Act is amended by inserting "(other than facilities subject to such jurisdiction solely by reason of section 202(b) and 205(k))" after "Part".

COGENERATION

SEC. 546. (a) COGENERATION RULES.—Not later than 1 year after the date of enactment of this title, the Commission shall, after consultation with representatives of State regulatory authorities, and after a reasonable opportunity for other interested persons to submit oral as well as written data, views, and arguments, prescribe rules requiring electric utilities to offer to sell electric energy to the owner or operator of a qualifying cogenera-

tion facility and to offer to purchase electricity [sic] energy from such owner or operator. Such rules shall insure that rates for such sales and purchases are just, reasonable, or in the public interest, and do not discriminate against cogeneration. Such rules shall include—

(1) rules for allocating costs of a qualifying cogeneration facility between those incurred in generating electric energy and those incurred in generating other forms of energy;

(2) rules respecting the interconnection of a qualifying cogeneration facility to the distribution system of any electric utility or to a centrally dispatched power pool as defined in section 202(b)(4)(B) of the Federal Power Act;

(3) rules respecting the responsibility of the owner or operator of a qualifying cogeneration facility during periods of electric shortage;

(4) rules respecting the minimum reliability standards for the qualifying cogeneration facility; and

(5) rules which specify the reliability of emergency electric energy service available to the qualifying cogeneration facilities.

Such rules may not (A) require an electric utility to purchase electric energy from a qualifying cogeneration facility during any period at a rate which exceeds the highest cost at which such utility generates electric energy, or purchases electric energy from any other source, during such period, or (B) authorize such cogeneration facility to make any sale for purposes other than resale.

(b) DEFINITIONS.—For purposes of this section:

(1) The term "cogeneration facility" means a facility which produces—

(A) electric energy, and

(B) other forms of useful energy (such as steam or heat) which is, or will be, used for industrial, commerial, or space heating purposes.

(2) The term "qualifying cogeneration facility" means a cogeneration facility which the Commission determines—

(A) meets such requirements respecting minimum size and fuel efficiency as the Commission, by rule, prescribes; and

(B) in the case of a cogeneration facility which is not owned by a utility and which is, or will be, directly connected to an electric utility, the owner or operator of such facility has offered such utility an opportunity to construct and operate such facility on terms acceptable to such owner or operator.

(c) ENFORCEMENT.—For the purposes of enforcement, a rule under this section shall be treated as a rule under the Federal Power Act.

(d) DELEGATION TO STATES.—The Commission may authorize (on such terms and conditions as it determines appropriate) any State regulatory authority to exercise any part of the Commission's authority under this section if the Commission determines that such State regulatory authority has the capability of effectively exercising such authority within its jurisdiction.

(e) EXEMPTION FROM FEDERAL POWER ACT.—Not later than 1 year after the date of enactment of this title, the Commission shall, after consultation with representatives of State regulatory authorities, prescribe rules exempting qualifying cogenerators in whole or part from the Federal Power Act, the Public Utility Holding Company Act, and from State laws and regulations respecting electric utility regulation, if the Commission determines such exemption is necessary to carry out the purposes of this title. No such exemption shall be modified, except for good cause shown, with respect to any such cogenerator after such exemption takes effect with respect to such cogenerator.

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Nos. 82-34 and 82-226

IN THE

Supreme Court of the United States

OCTOBER TERM, 1982

AMERICAN PAPER INSTITUTE, INC., *Petitioner*,

v.

AMERICAN ELECTRIC POWER SERVICE CORPORATION, *et al.*, *Respondents*.

FEDERAL ENERGY REGULATORY COMMISSION, *Petitioner*,

v.

AMERICAN ELECTRIC POWER SERVICE CORPORATION, *et al.*, *Respondents*.

On Writ Of Certiorari To The United States Court Of Appeals For The District Of Columbia Circuit

BRIEF OF DIAMOND SHAMROCK CORPORATION, HOFFMANN-LA ROCHE INC., MADISON PAPER INDUSTRIES, PARSONS & WHITTEMORE, INC., THE PORT AUTHORITY OF NEW YORK AND NEW JERSEY, UNION OIL COMPANY OF CALIFORNIA AS *AMICI CURIAE* IN SUPPORT OF PETITIONERS

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1982

No. 82-34 and 82-226

AMERICAN PAPER INSTITUTE, INC., *Petitioner*,

v.

AMERICAN ELECTRIC POWER SERVICE CORPORATION, *et al.*, *Respondents*.

FEDERAL ENERGY REGULATORY COMMISSION, *Petitioner*,

v.

AMERICAN ELECTRIC POWER SERVICE CORPORATION, *et al.*, *Respondents*.

On Writ Of Certiorari To The United States Court Of Appeals For The District Of Columbia Circuit

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BRIEF OF DIAMOND SHAMROCK CORPORATION, HOFFMANN-LA ROCHE INC., MADISON PAPER INDUSTRIES, PARSONS & WHITTEMORE, INC., THE PORT AUTHORITY OF NEW YORK AND NEW JERSEY, UNION OIL COMPANY OF CALIFORNIA AS *AMICI CURIAE* IN SUPPORT OF PETITIONERS

Diamond Shamrock Corporation, Hoffmann-La Roche Inc., Madison Paper Industries, Parsons & Whittemore, Inc., The Port Authority of New York and New Jersey and Union Oil Company of California file this brief as *amici curiae* in support

of petitioners to urge that the decision of the court below be reversed.

INTERESTS OF *AMICI CURIAE*

Amici curiae are five private companies and one public agency which engage in various operations throughout the United States. Diamond Shamrock Corporation is an energy and chemical concern. Hoffmann-La Roche Inc. manufactures pharmaceuticals, fine chemicals, vitamins and diagnostics. Madison Paper Industries, a joint venture formed by The New York Times Company and Myllykoski Oy, a Finnish company, operates a paper mill. Parsons & Whittemore, Inc. operates manufacturing facilities in the pulp and paper industry and, more recently, has constructed and operates resource recovery facilities that generate electricity from municipal solid waste. Union Oil Company of California is a natural resource concern engaged in oil and gas operations, minerals recovery, petroleum refining, chemical production and geothermal and oil shale projects.

The public *amicus curiae* is the Port Authority of New York and New Jersey, a joint agency of the two States created in 1921 by an interstate compact with the consent of Congress.[1] In 1978, the two States adopted legislation authorizing the Port Authority to provide for the development of industrial parks and resource recovery facilities. N.J.S.A. 32: 1-35.72 to 35.93; N.Y. Unconsolidated Laws §§ 7171-7192 (McKinney 1979). In 1979, Congress consented to the bi-State legislation. Pub.L. No. 96-163, 93 Stat. 1242 (1979). The Port Authority is now

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[1] See 42 Stat. 174 (1921) consenting to Ch. 154, Laws of N.Y., 1921; and Ch. 154, Laws of N.J., 1921. Pursuant to the compact and supplementary bi-state legislation, the Port Authority has been directed to plan, develop and operate terminals and other facilities of transportation and commerce within the Port of New York District, an area approximately within a 25-mile radius of the Statue of Liberty.

developing such facilities, which will, *inter alia*, convert garbage into steam and electricity.

Despite their diversity, these *amici curiae* have one interest in common. Each generates or plans to generate electricity by nontraditional means. Under a process known as cogeneration, *amici curiae* can burn fuels both to generate electricity and to supply steam needed for much of their industrial production. In addition, *amici curiae* are using or seeking to use various non-fossil fuel sources to produce electricity for sale in a competitive marketplace. The following examples give some idea of the kind of projects *amici curiae* have:

• At a calciner plant in California, a new waste heat recovery system will raise steam to drive a 25,000-kilowatt generator with energy that would otherwise be wasted. Lengthy negotiations with a traditional electric utility conducted within the framework of existing Federal Energy Regulatory Commission rules have yielded a long-term agreement with price tied to the utility's avoided cost.

• The nation's largest resource recovery plant began to turn municipal waste into enough electricity to supply 40,000 homes in Southern Florida after the Florida Public Service Commission ordered the traditional utility in the area to interconnect with the nontraditional facility.[2] Payments are being made to reflect the traditional utility's actual fuel savings, hour-by-hour.

• A new 200,000-kilowatt cogeneration facility in Texas generates electricity in two gas turbines, recovers waste heat

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[2] The utility has appealed this decision to the Florida Supreme Court which has not yet decided the case. *Metropolitan Dade County and Florida Power & Light Co.* v. *The Florida Public Service Commission*, No. 61,536 (argued October 5, 1982). In support of its interconnection order in that case, the Public Service Commission relies both on authority to order interconnections under State law and on the federal rule here at issue.

with which it produces high-pressure steam that drives a steam turbine, and then uses reduced-pressure steam in a chlorine caustic plant. A traditional utility buys all of the power under a one-year, evergreen contract. It pays a tariff rate set at the utility's average fuel cost multiplied by factors designed to approximate avoided energy cost. The utility has asked the Public Utility Commission of Texas to reduce those rates on the grounds that its avoided costs are decreasing as cogeneration in its service area increases from 300,000 to 1,000,000 kilowatts.

• A pulp mill in Alabama burns wood wastes, with coal as back-up fuel, generates steam and electricity for internal needs and sells a modest surplus to the nearby utility under a fixed-price contract.

• Innovative technology at a New Jersey plant that produces fine chemicals will utilize a slow-speed marine diesel engine to generate 23,000 kilowatts, enough electricity to satisfy plant needs, while simultaneously supplying close to a third of plant process steam requirements. As a result, one of the existing steam boilers will be placed in a standby capacity. Negotiations with the traditional utility are under way.

• Low-head hydroelectric projects on the property of a recently-expanded paper mill in Maine generate about 9,000 out of a maximum of 40,000 kilowatts consumed at the mill. An investor-owned utility is interconnected via lines owned by an intervening municipal electric utility. Contractual payments are tied to generic purchase rates set from year to year by the Maine Public Utilities Commission.

• A cogeneration facility in Texas generates almost a third of a chemical plant's internal needs while supplying process steam as well.

• Pursuant to Memoranda of Understanding with Essex County and the City of Newark, New Jersey, and with the City of New York, the Port Authority would provide several $200 million resource recovery facilities to convert garbage into steam and electricity, if economically feasible. The electric

capacity of each facility would approximate 30,000 kilowatts. Feasibility turns on securing satisfactory arrangements with utilities for interconnection and sale of electricity.

• A refinery in California is planning to install capacity to generate about 10,000 kilowatts of electricity from waste heat. The proposal will go forward only if projected revenues from the sale of electricity justify the investment.

The present and planned electric generating operations of *amici curiae* thus represent a broad spectrum of electric generating facilities, technologies and arrangements. Some of these facilities produce all their electricity for delivery to a traditional electric facility. Others use all electricity generated within the industrial plant. Some buy emergency or back-up power from a traditional utility, whereas others purchase all their plant needs under a conventional industrial rate schedule and sell all of their output. Some are negotiating long-term contracts with traditional utilities, others deal on a short-term contract or spot sales basis.

Each nontraditional facility requires interconnection with one or more traditional electric utilities (which usually hold a monopoly over the local electric transmission grid), and each has a vital stake in the payment mechanism for purchases by traditional, franchised-monopoly electric utilities from qualifying facilities. *Amici curiae*, as operators of these qualifying facilities, thus have a common—and important—concern for the proper administration of Section 210 of the Public Utility Regulatory Policies Act of 1978 (hereinafter "PURPA Section 210"), a statute which, as the Court has observed, was enacted to "encourage the development of cogeneration and small power production facilities." *FERC* v. *Mississippi*, No. 80-1749 (June 1, 1982), slip op. 6, 102 S.Ct. 2126, 2132.

Spurred by the enactment of PURPA Section 210, *amici curiae* and other industrial concerns are searching for new ways to generate electricity or increase their existing capacity. Each *amicus curiae* has—either in place or under consideration—cogeneration or small power production proj-

ects the economic viability of which could stand or fall on the outcome of this case. As the sponsors of PURPA Section 210 recognized, these projects and others like them could ultimately enable industrial firms to produce a large percentage of the national demand for electricity.[3]

By invalidating the FERC rule which mandates interconnections required for electricity transfers between qualifying facilities and electric utilities and by casting doubt on the reasonable and economically realistic pricing mechanism adopted by the Commission under PURPA Section 210, the court below has threatened the statute's effectiveness. *Amici curiae* believe that the congressional objective of PURPA Section 210 should not be impeded by improper judicial interference with the ability of the Commission to carry out its statutory responsibilities or by an erroneous judicial construction that jeopardizes the ability of industrial generators to sell electricity to electric utilities, which commonly are the principal, if not the only, available purchasers. *Amici curiae* therefore support petitioners in this case and urge that the decision of the court of appeals be reversed.

STATEMENT

A. PURPA Section 210

PURPA Section 210 was enacted primarily to overcome two impediments to the development of nontraditional electric generating facilities. First, as the Court observed in *FERC* v. *Mississippi*, No. 80-1749 (June 1, 1982), 102 S.Ct. 2126, traditional electricity utilities were reluctant to purchase power from, and sell power to, the nontraditional facilities. Slip op. at

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[3] *Public Utility Rate Proposals of President Carter's Energy Program (Part E of S. 1469): Hearings Before the Subcomm. on Energy Conservation and Regulation of the Senate Comm. on Energy and Natural Resources*, 95th Cong., 1st Sess. Pt. 1 at 141-43 (1977) (Report from the Library of Congress, Congressional Research Service).

6, 102 S.Ct. at 2132. In the graphic words of one witness before the House subcommittee:

> The declining use of cogeneration by industry in this country can be traced directly to the antagonism of the electric utility companies. They have virtually strangled cogeneration . . . by charging discriminatory backup rates to customers who cogenerate, and by either refusing to buy excess electricity from cogenerators or offering an unfairly low rate.[4]

The second impediment was that "regulation of these alternative energy sources by state and federal utility authorities imposed financial burdens upon the nontraditional facilities and thus discouraged their development." *FERC* v. *Mississippi*, slip op. at 6-7, 102 S.Ct. at 2132-33.

PURPA Section 210 addresses both impediments. The historic antagonism of utilities is met by provisions that call for federal adoption of purchase and sale rules for implementation by State regulatory authorities. The problem of undue regulatory burdens is met by authorizing FERC to prescribe rules exempting qualifying facilities "in whole or in part from the Federal Power Act, from the Public Utility Holding Company Act, from State laws and regulations respecting the rates, or respecting the financial or organizational regulation, of electric utilities . . ." PURPA Section 210(e)(1), 16 U.S.C. § 824a-3(e)(1).

1. Provisions In PURPA Section 210 Regarding Purchase and Sale Rules

PURPA Section 210(a) directs FERC to prescribe " 'such rules as it determines necessary to encourage cogeneration and small power production,' including rules requiring utilities to offer to sell electricity to, and purchase electricity from,

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[4] *Hearings on the National Energy Act (H.R. 6831) Before the Subcomm. on Energy and Power of the House Comm. on Interstate and Foreign Commerce*, 95th Cong., 1st Sess., Pt. 3 at 356-57 (1977).

qualifying cogeneration and small power production facilities." *FERC* v. *Mississippi*, slip op. at 7, 102 S.Ct. at 2133, quoting PURPA Section 210. Under subsection (b), these rules "shall insure that, in requiring any electric utility to offer to purchase . . . from any qualifying . . . facility, the rates for such purchase—

> (1) shall be just and reasonable to the electric consumers of the electric utility and in the public interest, and
>
> (2) shall not discriminate against qualifying cogenerators or qualifying small power producers.[5]

The statute explicitly provides that implementation of the purchase and sale rules is largely a State, not a federal, responsibility. PURPA Section 210(f) requires each State regulatory authority to "implement [the rules prescribed by FERC under subsection (a)] for each electric utility for which it has ratemaking authority."[6]

In sum, Congress fashioned an innovative regulatory mechanism, under which State ratemaking authorities follow standards set forth in federal rules, to overcome one of the two major impediments to increased generation of electricity by

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[5] PURPA Section 210(b) sets an upper limit on the amount utilities might be required under FERC rules to pay for electricity produced by cogenerators and small power producers. It provides that no FERC rule "shall provide for a rate which exceeds the incremental cost to the electric utility of alternative electric energy." 16 U.S.C. § 824a-3(b).

[6] PURPA Section 210(f), 16 U.S.C. § 824a-3(f). The constitutionality of this provision was upheld by the Court in *FERC* v. *Mississippi*, slip op. at 15-17, 102 S.Ct. at 2137-2138; see also, opinion of Justice O'Connor, concurring in part and dissenting in part, at 1, n.1, 102 S.Ct. at 2146, n. 1

Federal implementation of PURPA Section 210(a) is dealt with in subsections 210(g) and 210(h), which provide, *inter alia*, that FERC rules under Section 210(a) "shall be treated as . . . rule[s] under the Federal Power Act" for those who are subject to the Commission's jurisdiction under the Federal Power Act.

cogenerators and small power producers. The statutory provisions which establish this mechanism—PURPA Sections 210(a)-210(d) and 210(f)-210(h)—create both the authority and the obligations necessary to make it work. Under PURPA Section 210, FERC has both the authority and the obligation to prescribe purchase and sale rules, and State regulatory agencies have both the authority and the obligation to implement these rules.

2. Provisions In PURPA Section 210 Regarding Exemptions From Unnecessary Regulation

PURPA Section 210(e) is designed to remove the second impediment to increased cogeneration and small power production—the problem of unnecessary and unduly burdensome regulation. *FERC* v. *Mississippi*, slip op. at 7, 102 S.Ct. at 2133. Unlike the problem of utilities' historic refusal to deal, this problem can be solved without compelling any producer or user of electricity to act differently than it might otherwise act. Accordingly, PURPA Section 210(e) contains no provisions that compel action by these persons. Its function is to authorize FERC to grant freedom from existing regulatory obligations, not to impose new obligations.

Sections 210(e)(2) and 210(e)(3) set forth certain limitations on this authority. One of these limitations is that—

> (3) [n]o qualifying . . . facility may be exempted under this subsection [Section 210(e)] from—
>
> (B) the provisions of section 210, 211 or 212 of the Federal Power Act [16 U.S.C. 824i, 824j, or 824k] or the necessary authorities for enforcement of any such provision under the Federal Power Act [16 U.S.C. 791a et seq.]

Understanding the foregoing limitation on FERC's power to grant exemptions requires analysis of the three sections of the Federal Power Act to which PURPA Section 210(e)(3)(B) refers. Section 210 of the Federal Power Act, 16 U.S.C. § 824i (hereinafter "FPA Section 210"), grants FERC authority, upon application of any "electric utility . . . qualifying cogenerator or qualifying small power producer," to order,

inter alia, "the physical connection of any cogeneration facility, any small power production facility, or the transmission facilities of any electric utility, with the facilities of such applicant." Section 211 of the Act, 16 U.S.C. § 824j (hereinafter "FPA Section 211"), grants the Commission authority, upon application of "[a]ny electric utility or Federal power marketing agency," to order any other electric utility to provide transmission services to the applicant. Both sections set forth findings that the Commission must make before issuing an order, and both sections provide that, before an order is issued, further findings set forth in Section 212 of the Federal Power Act, 16 U.S.C. § 824k (hereinafter "FPA Section 212"), must be made.

The language of FPA Sections 210, 211 and 212 imposes no obligation upon cogenerators or small power producers, unless and until the Commission issues an order. The words of these sections—which, as enacted, bore the headings "Certain Interconnection Authority" and "Certain Wheeling Authority," (92 Stat. 3135-3136)—do not make these sections exclusive and do not compel cogenerators or small power producers to apply for the orders FERC is authorized to issue. In fact, the only obligations that could arise under the words of these sections of the Federal Power Act would arise by virtue of a valid order issued by FERC. Accordingly, the only obligation that an exemption from the provisions of FPA Sections 210, 211 or 212 would remove would be the obligation to obey specific Commission orders entered pursuant to those sections.

B. Pertinent Rules Promulgated By The Commission Pursuant To The Provisions In PURPA Section 210

Two provisions of the rules prescribed by FERC under PURPA Section 210 were declared unlawful by the court of appeals in this case. The first requires utilities to "make such interconnections [with qualifying facilities] as may be necessary to accomplish purchases and sales" (18 C.F.R. § 292.303(c)); the second requires that rates for utility purchases of electricity from "new capacity" must equal the utility's

"avoided costs determined [by the appropriate State ratemaking authority] after consideration of" certain factors set forth in the rules (18 C.F.R. § 292.304(b)(4)).

1. The Interconnection Rule

FERC's rule regarding interconnection of electric utilities with qualifying facilities appears in 18 C.F.R. § 292.303—a section in the rules entitled "Electric Utility Obligations under this Subpart." The first two obligations set forth in this section merely reflect the statutory direction to prescribe rules requiring electric utilities to offer to purchase electricity from and sell electricity to qualifying facilities. The third obligation, set forth in 18 C.F.R. § 292.303(c), is described in the Commission's preamble to the final rules as follows:

> Paragraph (c)(1) thus provides that an electric utility must make any interconnections with a qualifying facility which may be necessary to permit purchases from or sales to the qualifying facility. A State regulatory authority or nonregulated electric utility must enforce this requirement as part of its implementation of the Commission's rules. 45 Fed. Reg. 12,221.

The interconnection rule at issue in this case therefore requires utilities to do nothing more than what is necessary to comply with the purchase and sale requirements that PURPA Section 210(a) expressly mandates the Commission to prescribe. Moreover, even if the FERC rules had been silent on the matter of interconnection, State regulatory authorities would be bound by PURPA Section 210(f) to recognize—and enforce—a duty to interconnect as part of their statutorily-mandated implementation of the Commission's purchase and sale rules.

2. The Avoided Cost Rule

PURPA Section 210(b) directs that FERC's rules insure that rates of purchase and sale "shall be just and reasonable to the electric consumers of the electric utility and in the public

interest" and "shall not discriminate against qualifying [facilities]" (PURPA Section 210(b)). Pursuant to this statutory direction, FERC adopted a rule which imposes these standards upon State regulatory authorities *in haec verba*. See 18 C.F.R. § 292.304(a).

In addition, the FERC rules provide that, in many instances, these statutory standards can be satisfied only by purchase rates that are equal to the utilities' "avoided costs"—that is, equal to the incremental costs for electricity which, but for the purchase, the utility would generate for itself or purchase from another source. 18 C.F.R. § 292.304(b); see also 18 C.F.R. § 292.101(b)(6). The FERC rules distinguish "new" capacity from capacity for which construction was commenced prior to November 9, 1978. On purchases from "new" capacity, rates for purchases are deemed to meet the statutory standards only if they equal the purchasing utility's avoided costs, as determined by the State ratemaking authority. 18 C.F.R. § 292.304(b)(4).[7]

The Commission set forth its reasons for avoided cost purchase rates in its preamble to the final rules. See 45 Fed. Reg. 12,222-12,223. After summarizing the various positions asserted in comments on previously proposed rules, FERC noted the obvious. "[I]n most instances, if part of the savings from cogeneration and small power production were allocated among the utilities' ratepayers, any rate reductions will be insignificant for any individual customer." 45 Fed. Reg. 12,222. Conversely, as the Commission also observed—

> if these savings are allocated to the relatively small class of qualifying cogenerators and small power producers, they

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[7] For other purchases (i.e., from capacity for which construction began prior to November 9, 1978), the rates may be less than avoided costs if the State regulatory authority determines that a lower rate is consistent with the statutory standards and "is sufficient to encourage cogeneration and small power production." 18 C.F.R. § 292.304(b)(3).

> may provide a significant incentive for a higher growth rate of these technologies. *Id.*

Two methods of rate determination proposed in the comments were discussed and rejected by FERC. The first would have employed a so-called "split-the-savings" device, under which a utility and a qualifying facility would split the difference between the qualifying facility's incremental cost and the incremental cost the utility would have incurred had it generated the power itself or purchased it elsewhere. This method was rejected for several reasons, the most telling of which was that "it would require a determination of the costs of production of the qualifying facility"—a regulatory burden of the precise kind that PURPA Section 210 intends to remove. A second method of rate determination would have set purchase rates at a fixed percentage of the avoided costs. FERC rejected this method on the following reasoning:

> The Commission notes that, in most situations, a qualifying cogenerator or small power producer will only produce energy if its marginal cost of production is less than the price he receives for its output. If some fixed percentage is used, a qualifying facility may cease to produce additional units of energy when its costs exceed the price to be paid by the utility. If this occurs, the utility will be forced to operate generating units which either are less efficient than those which would have been used by the qualifying facility, or which consume fossil fuel rather than the alternative fuel which would have been consumed by the qualifying facility had the price been set at full avoided costs. 45 Fed. Reg. 12,222-12,223.

The avoided cost rules thus were adopted after full consideration and discussion of alternatives proposed. In the course of this discussion, FERC explained why it rejected the alternatives in favor of the avoided cost rule—a rule that embodies the simple concept of requiring the utility to pay a qualifying facility the cost the utility would incur to obtain the same electricity by internal generation or purchase from another supplier.

SUMMARY OF ARGUMENT

Under PURPA Section 210(f), State regulatory authorities are required to implement the purchase and sale rules prescribed by FERC under PURPA Section 210(a). By virtue of PURPA Section 210(f), State regulatory authorities therefore have the legal power to order utilities under their jurisdiction to make interconnections necessary for purchases and sales required by the FERC rules—even if these rules should not explicitly require such interconnections. By invalidating the FERC interconnection rule, the court below encumbers FERC's power to order interconnection with procedures and conditions that do not restrict the interconnection authority which PURPA Section 210(f) gives the States. State interconnection authority, moreover, cannot be restricted by PURPA Section 210(e)(3)(B)—the statutory provision upon which the court relied in curbing FERC's powers. This anamolous result, under which FERC is bound by restrictions that cannot be held to bind the State regulatory authorities, is consistent with neither the words of PURPA Section 210, nor with the purposes of the statute.

The holding of the court of appeals invalidating FERC's avoided cost rate rule is premised upon the court's erroneous view that PURPA Section 210 imposes a "balancing test," under which FERC is required to reach a compromise of three interests—the interest of electric consumers, the interest of cogenerators and small power producers and "the public interest." PURPA Section 210 contains no such "balancing test." Congress itself struck the balance and directed FERC to prescribe rules to insure that rates at which qualifying facilities purchase electricity meet each of three standards set forth in the statute. These rates must be "just and reasonable to electric consumers" and "in the public interest" and shall not "discriminate against qualifying cogenerators or small power producers." As FERC explains with precision and clarity in the preamble to its rules, the rule requiring avoided cost rates for purchases of electricity from new capacity does not discriminate against qualifying facilities and is demonstrably just

and reasonable to the electric consumer and in the public interest. The administrative record does not fail, as the court of appeals erroneously held, to explain the Commission's reasoning in reaching this virtually self-evident conclusion.

ARGUMENT

I.

THE COMMISSION'S RULE REQUIRING ELECTRIC UTILITIES TO MAKE INTERCONNECTIONS NECESSARY TO ACCOMPLISH PURCHASE AND SALE TRANSACTIONS WITH QUALIFYING FACILITIES IS NOT CONTRARY TO THE PROVISIONS IN PURPA SECTION 210

The interconnection rule, which the court of appeals held unlawful under PURPA Section 210, does little more than declare explicitly an obligation that PURPA Section 210 itself, by necessary implication, imposes upon electric utilities. PURPA Section 210(a) expressly directs FERC to prescribe rules that require electric utilities to offer to purchase electricity from and sell electricity to qualifying cogeneration and small power production facilities. PURPA Section 210(f) directs that, within one year after they are prescribed, each State regulatory authority must implement these rules. Since sales and purchases of electricity cannot take place without interconnection of electric facilities, the implementation provisions in PURPA Section 210(f), as well as the provisions of PURPA Section 210(a), must contemplate that utilities will be obliged to "make such interconnections . . . as may be necessary to accomplish purchase and sales"—precisely the obligation imposed by the FERC interconnection rule. 18 C.F.R. § 292.303(c).

The court of appeals, however, invalidated the rule, thus rejecting "the contemporaneous construction of a statute by the [Commission] charged with the responsibility of setting its machinery in motion." *Udall* v. *Tallman*, 380 U.S. 1, 16 (1965). This holding ignores the established canon of statutory con-

struction under which the courts give "great deference to the interpretation given the statute by the officers or agency charged with its administration." *Id.*; see also *Train* v. *Natural Resources Defense Council*, 421 U.S. 60, 75 (1975); *Red Lion Broadcasting Co.* v. *FCC*, 395 U.S. 367, 381 (1969).

PURPA Section 210 cannot properly be read to invalidate the FERC interconnection rule. PURPA Section 210(f) provides that implementation of FERC rules requiring utilities to purchase and sell electricity is a State responsibility. Consequently, the interconnections necessary for these purchases and sales to take place are primarily the responsibility not of FERC, but of State regulatory authorities.[8] By virtue of PURPA Section 210(f), these State agencies have not only the authority but also the obligation to implement rules requiring purchases and sales adopted by FERC under PURPA Section 210(a).

The opinion below nowhere mentions this State obligation, but the statutory provision upon which the court principally relies in holding that FERC has no authority to adopt an interconnection rule—PURPA Section 210(e)(3)(B)—provides no basis for restricting the authority granted to State regulato-

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[8] The FERC interconnection rule provides guidance for State regulatory authorities concerning their critical role in implementing the purchase and sale rules mandated by PURPA Section 210(a) and lays down principles for resolving the question of who must bear the costs resulting from operation between interconnected electric utilities and qualifying facilities. See 18 C.F.R. §§ 292.101(b)(7) and 292.306. In addition, under PURPA Section 210(h)(1), the Commission's interconnection rule, like all rules prescribed under PURPA Section 210(a), must be treated as "a rule under the Federal Power Act." The interconnection rule consequently provides an important federal enforcement alternative to support the State enforcement powers.

ry agencies under PURPA Section 210(f). These State implementation powers must include the power to direct utilities to make interconnections that are necessary for purchase and sale transactions with qualifying cogenerators and small power producers. Should State regulatory authorities not have this power, they would be legally unable to carry out the statutory command in PURPA Section 210(f) that they implement the purchase and sale requirements of PURPA Section 210(a).

The court below appears to have viewed the question presented by the Commission's interconnection rule as whether PURPA Section 210(e)(3)(B) expresses a Congressional intention that interconnection between electric utilities and qualifying facilities may be ordered by FERC only under the provisions of Sections 210 and 212 of the Federal Power Act.[9] By

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[9] FERC has, as well, other authority under the Federal Power Act to order interconnections, authority that both preceded PURPA and continues to exist. FPA Section 202(b), 16 USC § 824a(b), provides that, under certain circumstances, FERC may "direct a public utility . . . to establish physical connection of its transmission facilities with the facilities of one or more other persons engaged in the transmission or sale of electric energy." This section was added in 1935 to the Federal Power Act, 49 Stat. 848 § 213, and was not affected by the addition of new Power Act sections 210, 211 and 212 in 1978. *See* FPA § 212(e)(2) and H. Conf. Rept. 95-1750, p. 94. These latter sections have only the limited purposes of filling jurisdictional omissions in FERC's authority to order interconnection to the interstate grid and sale or exchange of electric energy by intrastate and other non-jurisdictional utilities (particularly in Texas) and to order certain transmission services. It also satisfies the Commission's long-standing desire for authority to act on its own motion.

FPA Sections 210 and 212 (and in most cases, 211) confer on cogenerators and small power producers as such and as "electric utilities" (broadly defined, with few exceptions, as sellers of electric energy), supplementary, but by no means exclusive, rights under the Federal Power Act. *See* FPA section 212(e)(1). Qualifying facilities are nowhere restricted in these sections regarding access to Section

holding that Section 210(e)(3)(B) of PURPA should be so read, the decision below creates the anomalous situation that State regulatory authorities can—and must, if they are to comply with PURPA Section 210(f)—order interconnection whenever necessary to implement the purchase or sale requirement of Section 210(a), while FERC's powers with respect to interconnection are restricted by the procedures and findings set forth in Sections 210 and 212 of the Federal Power Act.

This result was not intended by PURPA Section 210(e)(3)(B). The words of that subsection merely limit the Commission's power to exempt qualifying facilities from federal and State regulation as follows:

> No qualifying small power production facility or qualifying cogeneration facility may be exempted under this subsection from
>
> * * *
>
> (B) the provisions of section 210, 211, or 212 of the Federal Power Act [16 U.S.C. 824i, 824j, or 824k] or the necessary authorities for enforcement of any such provision under the Federal Power Act [16 U.S.C. 791a et seq.]

These words, read in accordance with their normal usage, mean simply that the Commission may not free qualifying facilities from obligations imposed by FPA Sections 210, 211 and 212. Moreover, the context in which these words appear—as part of a provision designed to free qualifying cogenerators and small power producers from the burdens of compliance

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202(b) of the Federal Power Act or independent state laws, much less the broad new purchase and sale rights conferred by PURPA Section 210(a). When P.L. 95-617 simultaneously enacted PURPA Section 210 and FPA Sections 210 and 212, Congress intended to create a full panoply of possibly duplicative rights, risking no omissions. It did not intend that any of these rights must be used to the exclusion of any other.

with unnecessary regulatory obligations—confirms that this meaning accords with the intent of Congress.

If an order under FPA Section 210, 211 and 212 should be entered, the provisions of these sections would apply to a qualifying facility—and nothing in the FERC rules under PURPA Section 210 provides otherwise. Absent such an order, however, the provisions of FPA Sections 210, 211 and 212 impose no obligation whatsoever upon cogenerators or small power producers. The Commission's interconnection rule—which imposes an obligation upon electric utilities to interconnect with qualifying facilities in order to effect the purchases or sales contemplated by PURPA Section 210(a)—does not operate to free qualifying facilities from any obligation that might be imposed upon them by an order entered under FPA Sections 210, 211 or 212. Accordingly, the Commission's interconnection rule does not violate PURPA Section 210(e)(3)(B) by "exempting" qualifying facilities from provisions of the Federal Power Act, and the contrary holding of the court of appeals does not follow the wording of PURPA Section 210.

The purposes of PURPA Section 210, moreover, do not support the construction adopted by the court of appeals. As the Court recognized in *FERC* v. *Mississippi*, *supra*, it was the historic antagonism of the traditional electric power industry toward cogeneration and small power production that prompted Congress to enact the statute. A holding that resort to the cumbersome procedures in FPA Sections 210 and 212 is required for FERC to compel recalcitrant utilities to make interconnections would give these utilities yet another procedural device to delay, and perhaps avoid altogether, their obligations to deal with cogenerators and small power producers.

The Federal Energy Regulatory Commission, with close to a half century of experience in regulating electric utilities, is the agency charged by Congress with federal administration of PURPA Section 210. This agency determined that a federal

interconnection rule was necessary to advance the objectives of that section in the face of electric utility opposition. This determination is consistent with the statutory language and fully in accord with its purpose. The determination therefore is well within the agency's lawful authority, and it should not be overturned by the strained construction of Section 210(e)(3)(B) espoused by the court below.

II.

THE COMMISSION'S RULE REQUIRING THAT A UTILITY'S RATE FOR PURCHASES OF ELECTRICITY FROM NEW CAPACITY MUST EQUAL THE UTILITY'S AVOIDED COST IS FULLY JUSTIFIED AS A RULE WHICH INSURES THAT PURCHASE RATES SHALL NOT DISCRIMINATE AGAINST QUALIFYING FACILITIES AND SHALL BE JUST AND REASONABLE TO ELECTRIC CONSUMERS AND IN THE PUBLIC INTEREST

The avoided cost rule, which the court of appeals held "FERC did not justify and explain," *American Electric Power Service Corp.* v. *FERC*, 675 F.2d 1226, 1245 *reh'g denied*, 675 F.2d 1246 (D.C. Cir. 1982), precisely carries out the Congressional mandate expressed in PURPA Section 210. In that section, Congress required promulgation of such rules as the FERC "determines necessary to encourage cogeneration and small power production." PURPA Section 210(a). Contemplating that such rules must deal with rates for purchases by traditional electric utilities, but not intending unlimited encouragement of nontraditional facilities, Congress directed that "no such rule . . . shall provide for a rate which exceeds the incremental cost to the electric utility of alternative electric energy." PURPA Section 210(b).[10] Congress also pre-

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[10] The court of appeals erroneously conceived the incremental cost ceiling expressed in PURPA Section 210(b) as being an absolute upper limit of meaningful encouragement. Rates above incremental (or avoided) cost, however, would go further to encourage nontraditional generation and reduce dependence on foreign oil. In fact, a

scribed the following standards for federal and State rate-setting authorities:

> The rules prescribed under subsection (a) of this section shall insure that, in requiring any electric utility to offer to purchase electric energy from any qualifying cogeneration facility or qualifying small power production facility, the rates for such purchase—
>
> (1) shall be just and reasonable to the electric consumers of the electric utility and in the public interest, and
>
> (2) shall not discriminate against qualifying cogenerators or qualifying small power producers.

The opinion below errroneously drew from these statutory standards a "clear intent of section 210(b)" of PURPA "to strike a balance" among the interests of cogenerators, electric consumers of utilities and the public interest (675 F.2d at 1234). The court's three-way balancing test is pure invention. Congress did not establish a scheme under which administrative officers would be called upon to devise a series of compromises that would somehow weigh the relative importance of different interests. Congress itself struck the balance, which it expressed in the overall rulemaking mandate of PURPA

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utility's reaction to a recent California Public Utilities Commission decision indicates that, in some circumstances, an avoided cost rate does not provide sufficient incentive to encourage cogeneration. The California Commission had approved a proposal by a traditional utility to build a 47-megawatt geothermal generating plant, but denied the utility's proposal to include costs in the utility's rate base. Instead, the Commission limited the utility to the recovery of its own avoided costs, allowing the shareholders to retain the profit if the power costs less but requiring them to absorb the loss in case of excess costs. In re Southern California Edison Co., CPUC Decision No. 82-10-049, Oct. 20, 1982. The California Commission, therefore, would have precisely matched the economic incentive offered qualifying facilities by the avoided cost rule. The traditional utility announced that it would not proceed on that at-risk basis. Los Angeles Times, Nov. 17, 1982/Pt. II, p. 7.

Section 210(a) and in the three standards it directed the agency to follow for purchase rate rules.[11]

Since FERC wisely decided that both detailed rate formulas and specific numerical rates should be set by State regulatory commissions, its purchase rate rule transferred to State authorities the mandate to encourage cogeneration and small power production, the ceiling on rates and the three statutory standards. These aspects of the FERC purchase rate rule are not controverted. Respondent utilities confine their attack to a provision that, in cases of new capacity, the rate for purchases satisfies the rule only if it "equals the avoided costs determined after consideration of [certain] factors" enumerated in the rule.[12]

This provision is necessary to counteract the reluctance of traditional utilities, enjoying legal and functional monopoly and monopsony powers, to deal fairly with qualifying facilities. Lacking a competitive market, the Commission's avoided cost rule goes directly to the heart of the problem by approximating

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[11] Perhaps the clearest demonstration of the court of appeals' departure from the express Congressional direction to encourage cogeneration and small power production is the following portion of the opinion in which the court below actually urges the FERC to discourage cogeneration and small power production so long as the discouragement is not "disproportionate":

> FERC should allocate the benefits more evenly between the cogenerators and the utilities if the utilities can demonstrate that, under a percentage of avoided cost approach, an allocation less heavily favoring the cogenerators is in the public interest and the interest of the utilities' electric consumers, and will not disproportionately discourage cogeneration. (675 F.2d at 1234).

[12] These factors concern utility costs and projections, "availability of capacity or energy" provided by the qualifying facility during daily and seasonal peak periods, "relationship of the availability of energy or capacity" provided by the qualifying facility to the utility's ability to avoid costs, defer capacity additions and reduce fossil fuel use, and savings related to line losses. 18 C.F.R. § 292.304(e).

the price that would prevail in a competitive market place. If a free market existed in each electric utility service area, cogenerators and small power producers would be able to secure the direct costs avoided by the utility that purchases electricity from them (at least to the extent these areas represent relevant economic markets). Under such conditions, nontraditional, at-risk producers of electric power would receive market-clearing prices, and these prices would approximate incremental costs of electricity in the area—which is precisely what the FERC rules have entitled new, at-risk capacity to receive.

The avoided cost rule meets the standards enacted in PURPA Section 210. Subsection 210(b)(1) refers to "the public interest." The opinion below would have the Commission set this interest against the "cogenerator interest" and the "electric consumer interest" and reach some kind of "compromise" without clear principle by which to appraise the result. Admittedly, the Commission did not follow this far-ranging and highly unstructured procedure. Instead it satisfied PURPA's demand that "the rates for such purchase . . . shall be . . . in the public interest . . ." by establishing a market-clearing, avoided cost principle to encourage generation of electricity by qualifying facilities without subsidization by electric utilities.

PURPA Section 210(b)(2) also provides that rates "shall not discriminate against qualifying cogenerators or qualifying small power producers." This standard means rate setting authorities may not discriminate against qualifying facilities. For example, purchase terms extended to other traditional utilities may not be withheld or changed in a discriminatory way to the detriment of qualifying facilities. The avoided cost rule meets this standard.

The third standard demands that "rates for such purchase . . . shall be just and reasonable to the electric consumers of the electric utility . . . ." The opinion below found in this standard the clearest sign of a balancing requirement—because "just and reasonable" in utility ratemaking has been held to call for a balancing as between utility stockholder and ratepayer in-

terests. *Cf. FPC* v. *Hope Natural Gas Co.*, 320 U.S. 591 (1944).

Principles derived from utility rate cases, however, cannot be used to interpret the pricing mechanism Congress ordained for cogenerators and small power producers. In setting rates for a public utility, the interest of the utility's consumers must be weighed against the conflicting interest of the utility's stockholders, and rates are "just and reasonable" if a balance is struck that allows the stockholders a fair rate of return on their investment. Under PURPA Section 210, qualifying facilities "are not guaranteed a rate of return on their activities . . . vis a vis the sale of power to the utility and [their] risk in proceeding forward in the cogeneration or small power production enterprise is not guaranteed to be recoverable." H. Conf. Rept. 95-1750 at 97. If avoided cost rates drive a qualifying facility out of business, that is a business risk, like all other risks an unregulated firm must take. Whatever compromise the phrase "just and reasonable" may imply in other contexts, PURPA Section 210 requires rates that are "just and reasonable to electric consumers," not just and reasonable as between consumers and others.

The Commission's avoided cost rule meets the statutory standard. Under an avoided cost rate, utilities pay not a penny more than the costs they would have incurred if no cogenerator or small power producer had entered the market (and therefore have no excuse to attempt to charge ratepayers a penny more). The Commission's rule does not require a utility to forego any economy it can achieve. The rule thus fully protects the consumer. Moreover, increased competition in electric power production encouraged by the avoided cost rule will benefit electric consumers by lowering the cost and presumably the price of electricity.

The opinion below discusses certain circumstances under which the court of appeals believed that the avoided cost rule would injure consumers. In particular, the opinion states "if a utility has excess capacity the additional cogeneration encouraged by full avoided cost payments will result in higher rates

for all remaining customers of the utility" and asserts that these "higher rates for . . . remaining customers" would come about "because that [additional] cogeneration will reduce the number of customer-purchased kilowatt-hours over which the utility can spread a share of the fixed costs of that extra capacity." 675 F.2d at 1235.

This reasoning does not withstand analysis. Electric energy which a cogenerator has been encouraged to produce by full avoided cost payments, by definition, will be sold to the utility for resale in lieu of electricity the utility would have generated itself or purchased elsewhere. The utility therefore will sell to its customers precisely the same amount of electric energy that it would have sold if there were no cogeneration. The utility thus will have the same number of customer-purchased kilowatt-hours over which to spread its fixed costs. The only effect of the Commission's rule is that the cogenerator will receive payments equal to the costs that the utility otherwise would pay to other suppliers or incur itself in generating needed electric energy. If, on the other hand, the court had in mind a situation in which a cogenerator elects to use the electricity it generates rather than sell it to the utility—a likely supposition because of the opinion's use of the term "remaining customers"—then the cogenerator has not been encouraged to generate by avoided cost payments, but as a consequence of high retail electric rates. The higher rates that "remaining customers" might have to pay in this situation stem directly from the cogenerator's reducing its demands on utility capacity by self-generation—an exercise of the fundamental freedom to buy less in response to market forces—not the result of the Commission's avoided cost rule.

The opinion below invites FERC to substitute a percentage range in place of its full avoided cost rule by assigning responsibility to the State commissions "to set rates within a range—*e.g.*, 80-100 percent—authorized by the Commission." 675 F.2d at 1234. FERC considered and rightly rejected this suggestion. 45 Fed. Reg. 12,222-12,223. This scheme would

force State regulatory authorities to waste precious resources attempting to make the, at best, speculative determination of which percentage within the prescribed range is "enough." Under the rule adopted by FERC, the State commissions have set themselves much more meaningful agendae as they pioneer the critical work of encouraging cogeneration and small power production.[13] For example—

- State commissions are defining cost avoidance factors (such as time of day and emergency demands) that will send price signals that encourage the most beneficial production.[14]
- State commissions are weighing the needs for price stability and predictability against a desire for accuracy and auditability.[15]

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[13] *See*, generally, The National Regulatory Research Institute, *The Appropriateness and Feasibility of Various Methods of Calculating Avoided Costs* (1982) (hereinafter "NRRI"). The NRRI is the institute, referred to in PURPA Section 603, 16 U.S.C. 2645, established by the National Association of Regulatory Utility Commissioners.

[14] For example, prescribed rates are higher for on-peak hours than for off-peak hours in States such as Connecticut and North Carolina. NRRI, *op. cit.* note 13, *supra*, pp. 9, 16. A Florida-prescribed rate formula tracks avoided fuel cost "on an actual hour-by-hour basis." Fla. Admin. Code § 25-17.82(2)(b).

[15] Several states have determined that avoided costs rates should be set at specific amounts that remain in effect until modified by the State commissions. *E.g.*, Vermont (up to 9.0 cents per kilowatt hour in peak periods, 6.6 cents in off-peak periods), Vermont Public Service Board, General Order No. 65 (June 18, 1981); New Hampshire (up to 8.2 cents per kilowatt hour), New Hampshire Public Utility Commission Order No. 14,280 in Docket No. DE 79-208 (June 18, 1980), reversed in part on other grounds, *Appeal of Granite State Electric Co.*, 435 A.2d 119 (N.H. 1981). A New York statute sets a permanent floor of 6 cents per kilowatt-hour under cogeneration and small power production rates for facilities developed on or after June 26, 1980. N.Y. Public Service Law §§ 2, 66-c (McKinney 1981). Maine sets

- State commissions are assessing the various nontraditional generation technologies relevant to their areas and selecting between class rates and across-the-board rates.[16]
- State commissions are closely investigating costs utilities can avoid, related to their fuel mix, power pooling, conservation programs and other economizing opportunities.[17]

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rates for a specified period based on projections of avoided costs. 65-407 C.M.R. Ch. 36, § 3B1. On the other hand, some states have opted for after-the-fact determinations of certain avoided costs actually experienced by a power pool, New Jersey Board of Public Utilities, Decision and Order issued October 14, 1981, in Docket No. 8010-687, or by each individual utility, Fla. Admin. Code § 25-17.82. The Texas Public Utility Commission has approved avoided energy costs calculated by reference to average fuel cost (an auditable figure, calculated routinely for retail rate purposes) multiplied by uniform factors to arrive at an easily audited estimate of avoided fuel cost. Order issued October 15, 1981 in Dkt. No. 3955.

[16] Many states have adopted rates which distinguish qualifying facilities by size (i.e., rates are generally more predictable for qualifying facilities below 100 kilowatts capacity) rather than by type of generation used. However, Oklahoma has required utilities to calculate capacity credits separately for wind generators, for hydroelectric power and for photovoltaic generation. Oklahoma Corporation Commission, Order No. 186937 in Cause No. 27208 (March 26, 1981).

[17] The analysis of avoided costs for purposes of PURPA Section 210 focuses attention on utility plans, projections and cost levels, as reflected in 18 C.F.R. § 292.302. The New Jersey Board of Public Utilities uses a formula rate based on billing determinants of a multi-state power pool, plus 10%, to determine energy payment. It adds an avoided capacity cost payment which may also be based on a power pool figure. (Alternatively, the avoided capacity cost may be tied to a long-run incremental cost analysis for the purchasing utility, adjusted to an optimal fuel mix so as not to penalize qualifying facilities for excessive dependence on oil-fired capacity in the State.) N.J. Board of Public Utilities, Decision and Order issued October 14, 1981, in Docket No. 8010-687. Whereas Idaho was long able to rely

- State commissions are grappling with the value of capacity furnished by cogenerators to the utility grid.[18]

Not a single State agency has availed itself of the procedure the Commission's rules provide for seeking waiver of the full

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almost completely on low-price hydroelectric power, the Idaho Public Utility Commission now finds new, coal-burning plants to be significant for analyzing avoided capacity costs. Idaho PUC, Order Nos. 15746 and 16025 in Case No. P-300-12 (issued August 8 and December 2, 1980).

[18] Determination of the cost of capacity avoided by reason of purchases from nontraditional facilities poses among the most complex issues within the sphere of PURPA concerns. The Oklahoma Corporation Commission, holding that lack of certainty does not justify outright denial of any capacity payments, has prescribed experimental formulae on the following reasoning:

> The fact that the Commission lacks hard data demonstrating quantifiable avoided capacity costs does not, however, dictate that the Commission make no allowance for assumed avoided costs in setting a purchase rate.

See op. cit, note 16, *supra*, at p. 4.

Maine bases capacity credits on analyis of each utility's 15-year generation expansion plan. 65-407 C.M.R. Ch. 36, § 3C. New Jersey uses the cost of peaking capacity and Idaho uses costs of baseload coal capacity. *See op. cit.* note 17, *supra*. For small facilities "capable of delivering firm power" Arizona requires a reasonable capacity credit of "not less than 10% of the standard rate" for energy, and possibly more. Arizona PSC Decision No. 52345 issued July 27, 1981, in Docket No. 81-045. Several states distinguish "firm" from "as available" capacity. *E.g.*, Mass. Admin. Code, Title 220, § 8.05. The Florida Public Service Commission has tied the right of qualifying facilities to be paid a capacity credit to achieving seventy percent equivalent availability, Fla. Admin. Code § 25-17.82(3), believed to be the average availability achieved by generating units of traditional utilities. Fla. PSC Docket No. 810296-EU. The Florida Public Service Commission also has a staff proposal for forthcoming rulemaking to base capacity credits for cogenerators on a cost-effectiveness analysis of payments traditional utilities make to encourage conservation by retail customers. Fla. PSC Order No. 10,943, June 28, 1982.

avoided cost rule,[19] and the challenge to this rule in the court below has come from the traditional electric utility industry, not from the State regulatory authorities. State Commissions are doing vital, practical work, following priorities they find important in regions and service areas for which each has responsibility, and demonstrating "the wide-spread interest and originality of State commissions in adapting the concept of avoided cost" realistically.[20] Perhaps never before has the electric utility industry faced such rigorous scrutiny or such a surge of new competition or such a challenge to economize.

The FERC rule was promulgated in direct response to a congressional mandate to develop just such rules, after consultation with State commissions, for implementation by State commissions. The rule is entitled to much "more than mere deference or weight."[21] Even were FERC's careful and skillful decision in this complicated field reviewable *de novo*, however, the rule should be upheld. The rule makes sense. Indeed, it is hard to conceive of a different rule that would better enable State commissions to get on with the real job at hand—encouraging the literally thousands of existing and potential cogenerators and small power producers to enter the market and help meet energy needs.

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[19] 18 CFR § 292.403(b) provides for waivers of certain FERC rules, including the avoided cost rule, on State commission petition. Commissions have expressly declined utility requests that they petition. *E.g.*, Fla. PSC Order No. 9970, April 22, 1981.

[20] NRRI, *op cit.*, note 13, *supra* p. 22.

[21] *Batterson* v. *Francis*, 432 U.S. 416, 426 (1977). *See also Vermont Yankee Nuclear Power Corp.* v. *Natural Resources Defense Council*, 435 U.S. 519, 558 (1978); *Permian Basin Area Rate Cases*, 390 U.S. 747, 791-792 (1968).

CONCLUSION

For the reasons stated, the decision of the court of appeals in this case should be reversed insofar as the decision holds any provisions in 18 C.F.R. Part 292 invalid.

Respectfully submitted,

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1982

AMERICAN PAPER INSTITUTE, INC.,
Petitioner,
v.
AMERICAN ELECTRIC POWER SERVICE CORPORATION, *et al.*,
Respondents.

FEDERAL ENERGY REGULATORY COMMISSION,
Petitioner,
v.
AMERICAN ELECTRIC POWER SERVICE CORPORATION, *et al.*,
Respondents.

On Writs of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

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MOTION OF EDISON ELECTRIC INSTITUTE FOR LEAVE TO FILE BRIEF AS *AMICUS CURIAE* IN SUPPORT OF RESPONDENTS AND BRIEF AS *AMICUS CURIAE* IN SUPPORT OF RESPONDENTS

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1982

Nos. 82-34 & 82-226

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MOTION OF EDISON ELECTRIC INSTITUTE FOR LEAVE TO FILE BRIEF AS *AMICUS CURIAE* IN SUPPORT OF RESPONDENTS

Pursuant to Rule 36.3, Edison Electric Institute ("EEI") moves for leave to file the attached *amicus curiae* brief in support of the Respondents. All parties other than Petitioner American Paper Institute and Respondent Elizabethtown Gas Company (whose brief supports the Petitioners) have consented to the filing of this brief, and their consents have been lodged with the Clerk. EEI regrets the necessity to submit this motion, *see On Lee v. United States*, 343 U.S. 924 (1952) (memorandum of Frankfurter, J.), but the strong interest of EEI's members in the disposition of this case and the presence of a number of *amicus curiae* briefs in support of the Petitioners (all of which were filed with consent pursuant to Rule 36.2) make it appropriate for EEI to submit its views.

EEI, which participated in the agency rulemaking, is the national association of investor-owned electric utilities. Its members are subject, directly or indirectly, to the rules of the Federal Energy Regulatory Commission ("the Commission") at issue in this case. Many EEI members are interconnected with cogenerators, and others are certain to interconnect in the future. Ratepayers of EEI member companies are or will be directly affected by the full avoided cost rule promulgated by the Commission.

The member utilities of EEI interact with cogenerators on a regular basis and have watched the cogeneration industry emerge over the past few years. The cogeneration industry has enjoyed continued growth since the lower court's decision. Because of the potential effects of this growth upon utility customers and upon the safety and reliability of the nation's power grid, EEI is submitting this brief in the hope it will be of assistance to the Court.

For the foregoing reasons, EEI respectfully moves for leave to file the attached brief as *amicus curiae* in support of the Respondents.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1982

Nos. 82-34 & 82-226

AMERICAN PAPER INSTITUTE, INC.,
Petitioner,

v.

AMERICAN ELECTRIC POWER SERVICE CORPORATION, *et al.*,
Respondents.

FEDERAL ENERGY REGULATORY COMMISSION,
Petitioner,

v.

AMERICAN ELECTRIC POWER SERVICE CORPORATION, *et al.*,
Respondents.

On Writs of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

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BRIEF OF EDISON ELECTRIC INSTITUTE AS *AMICUS CURIAE* IN SUPPORT OF RESPONDENTS

Edison Electric Institute ("EEI") submits this brief as *amicus curiae* in support of Respondents. For the reasons stated below, the decision of the Court of Appeals for

the District of Columbia Circuit in *American Electric Power Service Corp. v. Federal Energy Regulatory Commission*, 675 F.2d 1226 (D.C. Cir. 1982), should be affirmed.

INTEREST OF EDISON ELECTRIC INSTITUTE

EEI is the national association of investor-owned utility companies in the United States. Its members serve 99 percent of all customers of the investor-owned segment of the industry and over 75 percent of the nation's electricity users. EEI submits this brief because the agency action on review disregards ratepayer interests recognized in the Public Utility Regulatory Policies Act of 1978 ("PURPA"), Pub. L. No. 95-617, 92 Stat. 3117 (1978), and utility safety and reliability interests protected by the Federal Power Act, 16 U.S.C. § 824 *et seq.* (1976 & Supp. V 1981) ("FPA").

EEI participated in the Federal Energy Regulatory Commission ("the Commission") rulemaking that underlies this case. In light of the recognition in PURPA of the consumer interest in avoiding excessive electric rates, EEI argued for a rule providing a percentage-of-avoided-cost rate for cogeneration power,[1] so that there would be a sharing of the benefits of cogeneration between cogenerators and the ultimate customers to whom cogenerated energy is sold. The full avoided cost rule selected by the Commission deprives the ultimate customers of any participation in those benefits. EEI also pointed out to the Commission the dangers, from the standpoint of safety

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[1] For the sake of simplicity, the term "cogeneration" as used in this brief includes both cogeneration and small power production as defined in PURPA Section 201, 16 U.S.C. §§ 796(17)(A), 796(18)(A) (Supp. V 1981).

and reliability, that might arise if the Commission's interconnection authority were not exercised with due consideration of all the elements specified in the statute. The Commission chose, instead, to grant a blanket exemption from the statutory requirements.

Congress has spoken with regard to the role of cogeneration in the national energy policy, and the electric utility industry supports that program. A careful balancing of ratepayer, utility, and cogenerator interests explicitly recognized by Congress is essential if the congressional purposes are to be achieved. By confining its attention to cogenerator interests, the Commission failed to perform the functions contemplated by Congress.

SUMMARY OF ARGUMENT

Congress instructed the Commission to consider specific standards in promulgating interconnection and cogenerator rate rules. On both issues, the Commission issued a blanket order which effectively ignores the statutory standards. While approving other contested aspects of the cogeneration rules, the Court of Appeals remanded so that the agency might consider the two rules here at issue in light of those standards. The court neither dictated a particular result, substituted its judgment for that of the Commission, nor required the use of procedures beyond those called for by the statute.

1. *Interconnection.* Section 210(e)(3)(B) of PURPA, 16 U.S.C. § 824a-3(e)(3)(B) (Supp. V 1981), states that the Commission cannot exempt cogenerators from the procedural requirements for interconnection under the Federal Power Act. Section 202 of PURPA, which enacted FPA Section 210, 16 U.S.C. § 824i (Supp. V 1981), establishes the procedures to be followed when

a cogenerator seeks to compel a utility to interconnect. Contrary to this statutory framework, the Commission issued a blanket order requiring interconnection in every case and exempting cogenerators from the procedural requirements of the FPA.

Notwithstanding the deference ordinarily due an agency's statutory interpretation, no particular deference is owed the Commission's interpretation here since it lacks thoroughness and in any event conflicts with the language and legislative history of PURPA. The argument that PURPA Section 210(e)(3)(B) does not apply to a cogenerator unless the cogenerator is the *target* of the interconnection, rather than an *applicant* for interconnection, appears to have been fashioned from whole cloth and finds no support in the legislative history. The blanket interconnection rule offers no assurance that safety and reliability considerations will be taken into account.

2. *Full Avoided Cost.* Section 210(b) of PURPA, 16 U.S.C. § 824a-3(b) (Supp. V 1981), requires the Commission to insure that rates for cogenerated power be "just and reasonable to the electric consumers," and not in excess of 100% of the utility's incremental costs. The Commission's full avoided cost rule requires that states set rates at 100% of the utility's incremental costs in every case. The "just and reasonable" standard is disregarded.

The practical effect of the full avoided cost rule is to bestow all of the savings from cogeneration upon the cogeneration industry. The Commission failed to explain why the consumers for whose benefit the statute was in part passed should be denied rate benefits from this important new industry.

ARGUMENT

This is a relatively straightforward case about the duty of administrative agencies to apply the standards set by Congress. In the briefing thus far, the central issues have been obscured by a variety of devices.

First, and most surprisingly in the case of the Commission, Petitioners have invited this Court to look behind the opinion of a United States Court of Appeals in an effort to discern hostility to a major federal program and impeach the court's opinion by assertions that it may only be understood as a manifestation of some hidden, substantive judicial agenda. *See* p. 27 *infra;* FERC Br. at 16 & n.16, 17 & n.17; 21; API Br. at 15. Whatever the propriety of such efforts in the professional literature, *see, e.g.*, Breyer, Vermont Yankee *and the Courts' Role in the Nuclear Energy Controversy*, 91 Harv. L. Rev. 1833 & n.5 (1978), they have no proper place in the briefing process.

Second, much information concerning the presumed practical implications of alternative agency rules has been placed before this Court, even though the matters thus elaborated are classically of the type more properly addressed to the administrative agency than to a reviewing court. *E.g.*, NRDC Br. at 9-14; Diamond Shamrock Br. at 26-29; Kerr-McGee Br. at 15-19.

Third, the "parade of horribles," well known to this Court as a rhetorical device, has been carried to new lengths in this case. The consequences of the remand have been seriously overstated, *e.g.*, FERC Br. at 34; Kerr-McGee Br. at 6-7, and the ability of the Commission to reconcile the public interest in fostering cogeneration with the statutory requirement for notice and an opportunity for hearing before ordering an interconnection has been significantly underestimated. FERC Br. at 46; API Br. at 38-41.

None of this should be permitted to divert attention from the real—and rather narrow—issues in the case: did the Commission err (1) in concluding that the interconnection safety and reliability provisions of the FPA were subject to blanket exemption for cogenerators, and (2) in failing to articulate why it chose a cogeneration rate that was the absolute highest permitted under the statute? When the text of the statutes is considered, as well as the legislative history, it becomes clear that remand to the agency is not only consistent with the limited function of the reviewing court but necessary to vindicate the congressional intent.

I. THE COMMISSION'S BLANKET EXEMPTION OF QUALIFYING FACILITIES FROM THE INTERCONNECTION HEARING REQUIREMENTS OF THE FPA IGNORES THE MEANING AND PURPOSE OF THAT STATUTE AS WELL AS PURPA

A. Neither PURPA Nor the FPA Contemplates Blanket Exemptions from Interconnection Requirements

Cogeneration energy sources may be linked to conventional electrical transmission systems through physical interconnection with utility company equipment. Interconnection may be voluntary or involuntary. If the utility and the cogenerator are unable to negotiate an agreement to interconnect, the Commission may compel interconnection under the FPA. The Commission's mandatory interconnection rule, 18 C.F.R. § 292.303(c) (1982), however, goes further and shields cogenerators from the procedural and substantive requirements of the FPA which apply when voluntary interconnection is not achieved.

1. *The statutory framework.* Several sections of PURPA and the FPA come into play. FPA Section 210 (a) (1) (A), which was enacted by PURPA, provides the remedy for a cogenerator who seeks to interconnect over the objection of a utility:

> Upon application of any electric utility, Federal power marketing agency, geothermal power producer (including a producer which is not an electric utility), qualifying cogenerator, or qualifying small power producer, the Commission may issue an order requiring—
>
> (A) the physical connection of any cogeneration facility, any small power production facility, or the transmission facilities of any electric utility, with the facilities of such applicant[.] 16 U.S.C. § 824i (a)(1)(A) (Supp. V 1981).

The Commission may issue such an order only if it makes certain findings regarding efficiency, safety, and reliability. FPA Section 210(c) states:

> No order may be issued by the Commission under subsection (a) of this section unless the Commission determines that such order—
>
> (1) is in the public interest,
>
> (2) would—
>
> (A) encourage overall conservation of energy or capital,
>
> (B) optimize the efficiency of use of facilities and resources, or
>
> (C) improve the reliability of any electric utility system or Federal power marketing agency to which the order applies, and
>
> (3) meets the requirements of section 824k of this title [FPA Section 212]. 16 U.S.C. § 824i(c) (Supp. V 1981).

FPA Section 212(a), in turn, provides:

> No order may be issued by the Commission under section 824i of this title [FPA Section 210] . . . unless the Commission determines that such order—
>
> (1) is not likely to result in a reasonably ascertainable uncompensated economic loss for

any electric utility, qualifying cogenerator, or qualifying small power producer, as the case may be, affected by the order;

(2) will not place an undue burden on an electric utility, qualifying cogenerator, or qualifying small power producer, as the case may be, affected by the order;

(3) will not unreasonably impair the reliability of any electric utility affected by the order; and

(4) will not impair the ability of any electric utility affected by the order to render adequate service to its customers. 16 U.S.C. § 824k(a) (Supp. V 1981).

PURPA Section 210, 16 U.S.C. § 824a-3 (Supp. V 1981), does not exempt cogenerators from the procedural and substantive requirements of FPA Sections 210 and 212. Indeed, Section 210(e)(3)(B) contains the following non-exemption clause, which ensures that the safety and reliability concerns of utilities and their customers will be addressed when cogenerators seek interconnection:

> No qualifying small power production facility or qualifying cogeneration facility may be exempted under this subsection from—
>
> (B) the provisions of section 210, 211, or 212 of the Federal Power Act . . . or the necessary authorities for enforcement of any such provision under the Federal Power Act[.] 16 U.S.C. § 824a-3(e)(3)(B) (Supp. V 1981).

No other provision of PURPA or the FPA authorizes the Commission to grant exemptions from the FPA's interconnection requirements.

2. *The Commission's shifting analysis.* Notwithstanding its responsibility to implement these provisions as enacted, the Commission ignored the statutory scheme and announced a mandatory interconnection requirement.

The primary basis for the rule, as stated in the Notice of Proposed Rulemaking, was the belief that the "requirement to interconnect is . . . particularly subsumed within the requirement to buy and sell" under PURPA Section 210(a). 16 U.S.C. § 824a-3(a) (Supp. V 1981). Jt. App. at 47. In the final rule, the Commission turned to general language in FPA Section 212(e)(1), which provides that FPA Section 210 shall not be treated "as requiring any person to utilize the authority of such section 824i [FPA Section 210] . . . in lieu of any other authority of law," 16 U.S.C. § 824k(e)(1) (Supp. V 1981), to advance the theory that Congress must have meant that PURPA Section 210 was another "authority of law" covering interconnection by qualifying facilities. Pet. App. at B-60.

Petitions for agency rehearing pointed out that this interpretation rendered PURPA Section 210(e)(3)(B) superfluous. The Commission responded with the novel distinction that the non-exemption clause of PURPA Section 210(e)(3)(B) applies to those cases where the cogenerator is the "target" of an interconnection order. Pet. App. at B-180. It announced that the clause did not apply to cogenerators as "applicants" because there can only be an exemption from duties, liabilities, or requirements, and the ability to apply is "a grant of standing." *Id.* at B-182.

3. *Construction of the statute.* The issue before this Court has been framed as a matter of affording deference to agency interpretation. API Br. at 35-36. The Commission's interpretation here, however, cannot be accepted because it conflicts with the plain meaning and purpose of PURPA.

> Although an agency's interpretation of the statute under which it operates is entitled to some deference, 'this deference is constrained by our obligation to

> honor the clear meaning of a statute, as revealed by its language, purpose, and history.'

Southeastern Community College v. Davis, 442 U.S. 397, 411 (1979), *quoting Int'l Bhd. of Teamsters v. Daniel*, 439 U.S. 551, 566 n.20 (1979). This is just such a case. The Commission's interpretation, with its dismissal of the safety and reliability protections afforded under FPA Sections 210 and 212, "runs counter to the broad goals which Congress intended [the statute] to effectuate." *FTC v. Fred Meyer, Inc.*, 390 U.S. 341, 349 (1968). In addition, the Commission's reading fails to display the degree of thoroughness which is a prerequisite for judicial deference. *E.g., St. Martin Evangelical Lutheran Church v. South Dakota*, 451 U.S. 772, 783 n.13 (1981), *citing Skidmore v. Swift & Co.*, 323 U.S. 134, 140 (1944).

Looking to the plain meaning, FPA Section 210 is the only provision applicable to cases in which voluntary interconnection has not been achieved. It contains not the slightest hint that the interconnection application process may be dispensed with or varied when the applicant happens to be a cogenerator.

Because the statute is clear on its face, there is no occasion to explore the legislative history. Nonetheless, as shown in Respondents' brief, the legislative history of PURPA compels the conclusion that Congress intended cogenerators to apply for a Commission order when seeking to compel interconnection, and deemed the FPA to be the sole authority governing interconnection for purposes of sales to utilities. We would only add that the legislative history stressed by the Commission does not support the Agency's argument that the obligation to interconnect is "subsumed within the obligation to purchase." FERC Br. at 44. Proposed Section 546(a)(2) of the House bill, which did not survive the conference, required the promulgation of rules regarding interconnection with the "distribution system" of utilities and would have applied

only to the type of interconnection under which a customer takes electricity from the *distribution* facilities of the utility. H.R. 8444, § 546(a)(2), 95th Cong., 1st Sess. (1977). It did not cover the type of interconnection at issue here: interconnection with the transmission facilities to permit the cogenerator to transmit electricity to be sold to the utility. Moreover, the fact that Congress removed Section 546(a)(2)—the only provision of that PURPA Section 210 predecessor section that applied to any kind of interconnection—refutes the claim that Congress intended to subsume the ability to compel interconnection within the obligation to purchase from cogenerators.

Actions taken to delete language prior to final passage provide strong indication of the intent of Congress, *e.g.*, *Seatrain Shipbuilding Corp. v. Shell Oil Co.*, 444 U.S. 572, 596 (1980), and actions of conferees are to be given great weight for they establish that the final product "was the result, not of inadvertence, but of deliberate action." *United States v. Pfitsch*, 256 U.S. 547, 551 (1921). The congressional handling of proposed Section 546(a)(2) provides significant added support for the view that the drafters did not intend to exempt cogenerators from the framework for interconnection that was already in place in the FPA amendments.

It remains to address briefly two other ancillary arguments that have been advanced in support of the Commission's interpretation. One rests on the portion of FPA Section 212(e) that states that "[n]o provision of Section 824i of this title [FPA Section 210] shall be treated . . . as requiring any person to utilize the authority of such Section 824i of this title [FPA Section 210] . . . in lieu of any other authority of law." 16 U.S.C. § 824k(e) (Supp. V 1981). That provision was intended to preserve other bases for interconnection under the FPA such as

FPA Section 202(b). 16 U.S.C. § 824(b)(2) (1976 & Supp. V 1981).[2] It has nothing to do with relief for cogenerators from the interconnection requirements.

Finally, several of the briefs before the Court seek to validate the Commission's interconnection rule by arguing that the non-exemption clause of PURPA Section 210(e)(3)(B) applies to cogenerators only when they are "targets" of interconnection, not when they are "applicants." API Br. at 32; Kerr-McGee Br. at 26-27; Diamond Shamrock Br. at 10. The Court of Appeals noted that it had been pointed to "no evidence in the legislative history or the statute itself to justify this interpretation," Pet. App. at B-24 to -25, and the cited briefs do nothing to remedy this because there is no support for a "target"/"applicant" distinction.

4. *Policy arguments.* Petitioners are left with various policy arguments as to why cogeneration interconnection should be exempt from the general requirements for interconnection. Such arguments are, of course, more properly addressed to Congress, and cannot replace the plain language of the statute. *Reiter v. Sonotone Corp.*, 442 U.S. 330, 344-45 (1979). Indeed, these arguments have been addressed to Congress quite recently. Under H.R. 6500, introduced during the 97th Congress, "[c]umbersome sections 210 and 212 of the Federal Power Act would no longer apply to the interconnection of qualifying facilities with utilities." *Cogeneration and Small Power Production: Hearings on H.R. 6500 Before the Subcomm. on Energy Conservation and Power of the*

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[2] "Subsection (e) of new section 212 expresses the intention of the conferees that the authorities granted in sections 210 and 211 are in addition to and not in lieu of other authority the Commission may have under the Federal Power Act." H. Rep. No. 95-1750, 95th Cong., 2d Sess. 94 (1978), *reprinted in* 1978 U.S. Code Cong. & Ad. News 7797, 7828 ("Conf. Rep.").

House Comm. on Energy and Commerce, 97th Cong., 2d Sess. 2 (1982) (statement of Rep. Ottinger). Neither H.R. 6500 nor its counterpart, S. 1885, was passed.[3]

B. The Commission Ignored Reliability and Safety Issues Which Are the Reasons For Interconnection Hearings

Safety and reliability are issues of fundamental importance to utilities. The ability to provide adequate and reliable service to customers may be affected by interconnection with new entities such as cogenerators. For example, "[t]here are cases in which for technical reasons an interconnection involving the backfeed of power into the utility system must not be made at all."[4] Congress provided a procedure for issuance of orders when utilities and cogenerators disagree on these matters. Interconnection may be compelled only upon a finding under FPA Section 212(a) that it will not result in an undue burden on the utility system, an unreasonable impairment of system reliability, or an impairment of the ability to render service. 16 U.S.C. § 824k(a) (Supp. V 1981). By exempting cogenerators from the procedural and substantive requirements, the Commission has frustrated the congressional policy of protecting the utility from adverse safety or reliability consequences of interconnection.

The Commission's mandatory interconnection rule denies utilities and their customers the protection of safety and reliability standards expressly recognized in FPA Sections 210 and 212. Those standards are critical to utility efforts to provide safe, reliable service. As one utility representative observed, "[t]he substantive safeguards established in PURPA are of vital importance.

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[3] The bill would also have created a presumption in favor of full avoided cost rates for cogeneration energy. *See* pp. 19-30 *infra*.

[4] Cogeneration and Small Power Production: Hearings on H.R. 6500, *supra*, at 117 (statement of Bertram Schwartz, Consolidated Edison Co. of New York, Inc.).

Failure to adhere to them could lessen the reliability of an electric utility's system, increase the possibility of instabilities, make voltage control ineffective and endanger human safety." [5]

The Commission's rule emphatically does not provide the same safety and reliability safeguards afforded utilities by the statute, as one Petitioner claims. API Br. at 33-35. It does not incorporate the specific considerations set forth in FPA Section 212(a), let alone require the cogenerator to establish conformity with those considerations. The argument that it would be pointless to make the additional findings required under FPA Section 210 overlooks the additional findings required with respect to the burden on the system, impairment of reliability, and ability to render service.[6]

Petitioners point to state commissions as protectors of utility safety and reliability interests as cogenerators seek to interconnect with utilities. API Br. at 34 n.33. Yet, Congress had a federal interest in mind when it enacted FPA Sections 210 and 212, and therefore placed the responsibility to protect safety and reliability concerns directly with the Commission when interconnection proceedings are initiated under the FPA. The mandatory interconnection rule does not require the states to make findings on safety and reliability similar to those required by FPA Section 212. To the extent the Commission's PURPA rules *allow* states to speak to safety and reliability (*e.g.*, "[a]ny State regulatory authority . . . *may* establish reasonable standards to ensure system safety and reliability of interconnected operations" 18

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[5] *Id.*, at 197 (statement of Glenn J. Bjorklund, Southern California Edison Co.).

[6] The fact that these findings may not be difficult to make establishes nothing more than that interconnection proceedings for cogenerators will be narrowly focused, and therefore likely prospects for streamlining in the hands of the agency. *See* pp. 15-16 *infra*.

C.F.R. § 292.308 (1982) (emphasis added)), fewer than half have chosen to address these concerns. Of the 45 states which have promulgated implementing rules or standards, only 20 discuss minimum safety and reliability requirements. Few states address these matters in sufficient detail to assure that interconnections will not harm utility system safety and reliability.

C. Interconnection with Cogenerators Can be Fostered by Less Drastic Means Than a Blanket Exemption

The Court of Appeals properly observed that means less sweeping than a blanket exemption—such as streamlined procedures—exist to facilitate interconnection with cogenerators while ensuring due consideration of safety and reliability issues. Pet. App. at B-23. Petitioners' rejection of this analysis is based on the assumption that the Commission will be incapable of adopting such procedures. This assumption merely reflects the fact that the Commission has yet to try, as it has done successfully in other contexts,[7] to adopt the kinds of procedures and guidelines that ensure expedited action.[8]

Drawing on its expertise in the interconnection field, and its experience over decades of adjudicatory proceedings, it would be astounding if the Commission could not find ways to narrow the issues and provide guidelines as

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[7] FPC v. Texaco, Inc., 417 U.S. 380 (1974); Permian Basin Area Rate Cases, 390 U.S. 747 (1968). More recent illustrations of the Commission's ability to provide guidelines on recurring evidentiary matters include the Commission's rules regarding the inclusion of construction work in progress in rate base, 18 C.F.R. § 2.16 (1982), and the determination of "price squeeze" issues. 18 C.F.R. § 2.17 (1982).

[8] The assumption also appears to be present that the utilities possess unlimited litigative resources far out of proportion to those of would-be cogenerators. This disregards the impact of federal and state commission oversight of utility expenditures as well as the fact that many of the cogenerators are themselves industrial behemoths in no danger of being overwhelmed by any adversary in agency proceedings.

to recurring evidentiary questions. The Commission unquestionably has authority to particularize the FPA Section 210 and Section 212 standards through the rulemaking process. *See FPC v. Texaco, Inc.*, 417 U.S. 380 (1974). Expedition would also be served by familiar administrative techniques such as "fast-track" scheduling, waiving initial decisions, identifying lead cases and giving them a calendar preference, restricting discovery, and consolidating proceedings. These rather conventional procedures would not be too burdensome, API Br. at 40, and would not be contrary to evidentiary hearing and substantial evidence requirements. FERC Br. at 46 n.47. If expedited procedures prove unsatisfactory, the parties could, as the Court of Appeals stated, Pet. App. at B-23, seek amendment of the statute. The Commission may not, however, take the law into its own hands and excuse cogenerators from compliance with the statute.

The fear that agency procedures will themselves frustrate the development of cogeneration is equally misplaced. There is no reason to assume, as at least some of the cogenerators do, that *every* cogenerator will have to seek an interconnection order, and that the FPA requirements will create an "obstacle course." Kerr-McGee Br. at 6. An overwhelming crush of cases is hardly likely. In many cases, interconnection will be achieved through voluntary agreement. Where agreement cannot be achieved because of disagreement over safety and reliability issues, the Commission has the authority to dispense with a hearing when no material facts are in dispute.[9] Protracted agency proceedings thus would be unlikely.

Other objections to requiring interconnection proceedings on a case-by-case basis are equally unconvincing.

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[9] Kerr-McGee's claim that adjudicatory hearings will be required in every case is misleading. Kerr-McGee Br. at 28-30. A hearing in proceedings under the FPA need be held only when there is a factual dispute on a material issue. *E.g.*, Citizens for Allegan County, Inc. v. FPC, 414 F.2d 1125 (D.C. Cir. 1969).

API, for example, draws the Court's attention to the Commission's proposed fee for a contested interconnection proceeding—some $57,000. API Br. at 39 n.41. EEI agrees with the cogenerators that this is excessive; like the cogenerators, the electric utility industry filed comments opposing this proposal.[10] Even if the proposed rule is accepted by the Commission over the objections of this united front, applicants whose projects cannot bear the expense may obtain a waiver. 47 Fed. Reg. 39,851, 39,860 (1982) (to be codified at 18 C.F.R. § 381.106). Similar claims have been made that adjudicatory hearings before the Commission are "prohibitively expensive," costing approximately $1,500 per hearing day. Kerr-McGee Br. at 29. The support for this claim, however, is a study of *curtailment* proceedings,[11] which involve more numerous parties and more controversial issues than would an interconnection proceeding.

At bottom, Petitioners' objections amount to variations on the theme that the electric utility industry will fight interconnection applications at every turn. Such fears have no part in the proper disposition of this case and only poison the atmosphere in which utilities have been working and will continue to work constructively with cogenerators to assist in energy facility development. It flies in the face of experience and regulatory policy to assume that the remand to the agency "would give utilities a powerful tool with which they could hinder, delay and ultimately extract onerous terms from project developers . . . ." API Br. at 40.[12] Far from being in the

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[10] Comments of EEI, FERC Dkt. No. RM82-38-000 (Nov. 1, 1982).

[11] Pierce, *The Choice Between Adjudication and Rulemaking for Formulating and Implementing Energy Policy*, 31 Hastings L.J. 1 (1979).

[12] The lack of foundation for API's contention is apparent from the paucity of evidence it cites. Even those materials it does iden-

business of fighting project developers, utilities seek reliable sources of supply, including cogeneration, at least cost, to help meet customer needs.[13] There is no lack of evidence of utility efforts going far beyond voluntary interconnection agreements. Some, for example, have assisted cogenerators by assuming cogenerator project risks or guaranteeing their debt.[14]

In short, claims of delay, regulatory paralysis, the potential demise of cogeneration, and the risk of abuse of procedures require acceptance on faith that the Commission will stand idly by while utilities overwhelm cogenerators in a regulatory war of attrition. Utilities have yet to see evidence of a laissez-faire Commission approach to proceedings under its jurisdiction, and the assumption that the Commission is a helpless, pitiful giant incapable of regulating its own proceedings does an injustice to the agency and gives litle credit to those on whose expertise Petitioners place such great weight.

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tify turn out not to support the point. Thus, in Central Power & Light Co., FERC Dkt. No. EL79-8, cited by API at p. 39, n.42, the underlying dispute antedated PURPA, and involved efforts by Texas utilities to resist requests by Oklahoma utilities for interconnection. It is not a cogeneration case; it is an extension of an inter-utility dispute into the new procedural forum authorized by FPA Section 210. It offers no guidance as to how cogenerator applications will proceed.

[13] FERC As A Least-Cost Regulator: Hearings Before the Subcomm. on Energy Conservation and Power of the House Comm. on Energy and Commerce, 97th Cong., 2d Sess. 217-18 (1982) (testimony of Jerry L. Maulden, Arkansas Power and Light Co.).

[14] *E.g.*, Pacific Gas and Electric Company, 46 PUR 4th 257 (Cal. Pub. Utils. Comm'n 1982) (utility agreement to levelized payments above avoided costs to facilitate financing); Pacific Gas and Electric Company, Order No. 61117 (Cal. Pub. Utils. Comm'n July 7, 1982) (utility guarantee of facility bonds).

II. THE COMMISSION FAILED TO EXAMINE WHETHER FULL AVOIDED COST RATES ARE JUST AND REASONABLE TO ELECTRIC CONSUMERS

A. The Statute Requires That Rates Be Just And Reasonable To Electric Consumers, But The Commission Failed To Examine That Issue

Section 210 of PURPA requires utilities to purchase power from cogenerators and small power producers. 16 U.S.C. § 824a-3 (Supp. V 1981). The costs of this power are then included in the utility's own cost of service and, in this fashion, ultimately borne by its customers. Section 210(b) requires the Commission to "insure" that rates for these purchases shall be "just and reasonable to the electric consumer," and that those rates shall never exceed 100% of the utility's avoided cost.[15] By adding Section 210(b), Congress expressed its concern for "protecting the interests of the electric consumer in receiving electric energy at equitable rates." Conf. Rep. *supra*, at 97, 1978 U.S. Code Cong. & Ad. News at 7831. However, Congress also felt that the ratemaking procedure for cogenerators "should not be burdened by the same examination as are utility rate applications, but rather in less burdensome manner." *Id.* at 98, 1978 U.S. Code Cong. & Ad. News at 7832.

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[15] Section 210(b) provides:

> (b) The rules prescribed under subsection (a) of this section shall insure that, in requiring any electric utility to offer to purchase electric energy from any qualifying cogeneration facility or qualifying small power production facility, the rates for such purchase—
>
> (1) shall be just and reasonable to the electric consumers of the electric utility and in the public interest, and
>
> (2) shall not discriminate against qualifying cogenerators or qualifying small power producers
>
> No such rule prescribed under subsection (a) shall provide for a rate which exceeds the incremental cost to the electric utility of alternative electric energy. 16 U.S.C. § 824a-3(b) (Supp. V 1981).

In short, Congress looked to the Commission to insure that rates for cogenerated energy are "just and reasonable to electric consumers," without resort to the painstaking analysis of costs of service that typifies conventional utility ratemaking proceedings.

The Commission responded to this assignment by the simple device of dismissing the savings to the ratepayer as "insignificant," Pet. App. at B-65, and commanding the states to set rates for cogenerated energy across-the-board at 100% of the utility's avoided cost. Full avoided cost is the highest level allowed by the statute. Aside from a rote incantation of the statute at the beginning of the Order, *id.* at B-62, the phrase "just and reasonable" was never mentioned, and the substance of the concept never discussed.

B. The Commission Failed to Explain Why Full Avoided Cost Rates are Just and Reasonable to Electric Consumers

When a utility purchases cogenerated power at less than its full avoided cost, the resultant savings ultimately benefit the customers of that utility. Before PURPA was passed, it was thought that these consumer savings would be significant.[16] By the Commission's own admission, however, "the full avoided cost standard will not produce any rate savings to the utility's customers." FERC Br. at 20, *quoting* Pet. App. at B-65. Instead of examining the "just and reasonable" issue, the Commission's Order lists three reasons why all savings should go to the cogeneration industry rather than to consumers. These assumptions in no way show that the resulting rule is "just and reasonable to electric consumers."

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[16] For example, Senator Hart of Colorado, *citing* a Dow Chemical Company study in support of an earlier cogeneration bill, promised that "cogeneration can save household consumers as much as $3.6 billion every year in reduced utility bills." 123 Cong. Rec. S16,397 (daily ed. Oct. 5, 1977).

1. *Impact on individual ratepayers.* The Commission first noted that if less than full avoided costs were allowed, "any rate reductions will be insignificant for any individual customer." Pet. App. at B-65. Estimates of the actual impact upon consumers vary. Senator Hart's statement, note 16 *supra*, indicates that potential savings may be quite large in the aggregate, while one *amicus* states that the savings would be "at most 4 percent of the *incremental* cost of generation." Kerr-McGee Br. at 21-22 n.26. Even the latter figure can be quite significant, particularly for large industrial consumers. The Commission's Order leaves the reader with no idea how much money is involved, Pet. App. at B-65, nor does it attempt to gauge the actual impact upon consumers.

A similar error occurred in *FPC v. Texaco, Inc.* There, the Commission's predecessor agency had the duty to determine whether natural gas rates were "just and reasonable" under the Natural Gas Act of 1938, 15 U.S.C. § 717 *et seq.* (1976 & Supp. V 1981). The FPC decided to exempt small producer rates from direct regulation by a blanket order. There, as here, the argument was advanced that the effect of these rates upon the ultimate consumers was insignificant. Noting that the Commission admitted that small producer rates could have a significant effect "in some situations," this Court concluded:

> Even if the effect of increased small-producer prices would make a small dent in the consumer's pocket, when compared with the rates charged by the large producers, the Act makes unlawful all rates which are not just and reasonable, and does not say a little unlawfulness is permitted. 417 U.S. at 399.

The lesson of *Texaco* is clear: when charged with establishing just and reasonable rates, the Commission cannot simply dismiss that issue on the grounds that these

rates will make "a small dent in the consumer's pocket." [17] The Commission therefore erred in believing in this case that it could dismiss ratepayer impacts that were small considered on an individual basis.

2. *Range of available procedural options.* The Commission's second assumption was that a "split-the-savings" approach, which would permit consumers to enjoy at least some rate benefit from cogeneration, would be too burdensome because "it would require a determination of the costs of production of the qualifying facility." Pet. App. at B-65. The Commission evidently assumed that it had only two choices: either dismiss the "just and reasonable" issue out of hand (as it did), or conduct a full-scale evidentiary hearing into the costs of every cogenerator. No such dilemma existed, however, since a wide middle ground lies between these two extremes. The Commission failed to explore that middle ground.

The Commission has been faced with a similar task before. In *Permian*, the FPC issued an order establishing maximum rates for sales of natural gas. In holding that the FPC need not inquire into every producer's cost of service, this Court explained what was required in a "just and reasonable" determination:

> This Court has repeatedly recognized that legislatures and administrative agencies may calculate rates for a regulated class without first evaluating the separate financial position of each member of the class; it has been thought to be sufficient if the

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[17] Indeed, Commission jurisdiction over electric rates was created in part because state law was inadequate to protect the interests of individual consumers "who would have, *in the aggregate*, an interest in the interstate rate." Public Utilities Commission of Rhode Island v. Attleboro Steam & Electric Co., 273 U.S. 83, 90 (1927) (emphasis added). Because of the aggregate effect of the small interests of millions of consumers, state regulation constituted a direct burden on interstate commerce and federal regulation was required. *Id.* Thus, the duty to protect the aggregate interests of consumers goes to the heart of the Commission's regulatory function.

> agency has before it representative evidence, ample in quantity to measure with appropriate precision the financial and other requirements of the pertinent parties. 390 U.S. at 769 (citations omitted).

Here, however, the Commission made no attempt to gauge "financial requirements" of the parties, as required under *Permian*. It could have done so in a variety of ways without necessarily holding a full hearing into the costs of each cogenerator. For example, it could have (1) set rates at a fixed percentage of avoided costs, and allowed each cogenerator or class of cogenerators to prove that it requires a higher rate in order to proceed with an economically viable project that will serve the public interest; (2) considered cogenerator costs by class, according to type of energy source or facility size; or (3) established an avoided cost range, and allowed state commissions to set rates within that range. At the very least, the Commission could have (4) examined the cost of representative existing cogenerators, and made its determination on the basis of this evidence, with appropriate safety valves, *see* 390 U.S. at 770-71, for cases not fairly subsumed within the representative class.

Because the Commission chose to ignore these and other alternatives, it failed to conduct the examination contemplated by *Permian*, and its action therefore falls far short of the requirements for a "just and reasonable" determination.

3. *Encouragement of cogeneration.* The Commission's final hypothesis was that full avoided costs "may provide significant incentive" for some cogenerators. Pet. App. at B-65. The goal of encouraging cogeneration is found in Section 210(a) of PURPA, but the "just and reasonable" requirement is also a command of the statute. The Commission's apparent position is that, if there is a chance that a full avoided cost rule might be needed to encourage the last kilowatt of some hypothetical cogenerator, other requirements of the Act can be ignored. The "just and

reasonable" standard was part and parcel of Congress' plan, and may not be subordinated to any other part.

The Commission's hypothesis is also wrong because a full avoided cost rule is not necessary to encourage cogeneration. For example, one *amicus* supporting Petitioners quotes a utility official as stating that his company has signed more than 60 cogenerator contracts, and that "nearly all" of these have been for less-than-full avoided cost. NRDC Br. at 10 n.10, *citing Public Utility Regulatory Policies Act Amendments: Hearings on S.1885 Before the Subcomm. on Energy Regulation of the Senate Comm. on Energy and Natural Resources*, Pt. 2, 97th Cong., 2d Sess. 110, 114, 131 (1982) (statement of Glenn J. Bjorklund, Southern California Edison Co.). This experience suggests that cogenerators do not need full avoided cost rates in order to make a profit. It is also revealing that in the period since the Court of Appeals remanded the Commission's full avoided cost rule, the number of applications for qualifying facility status has *doubled*.[18] The assumption, therefore, that a full avoided cost rule is needed to encourage cogeneration does not reflect business realities.

4. *Post hoc rationalizations.* Thus far we have addressed those arguments advanced by the Commission in support of its full avoided cost rule at the time it was promulgated. Since then, a variety of new arguments have been unveiled in an effort to buttress this aspect of the Order. As *post hoc* rationalizations of appellate counsel, these cannot be accepted. *E.g., SEC v. Chenery Corp.*, 332 U.S. 194, 195 (1947). In any event, the arguments are incorrect on the merits.

The Commission now attempts to justify its full avoided cost rule by citing that portion of PURPA Sec-

[18] In the 11 months following issuance of the decision, potential cogenerators filed 241 applications for qualifying facility status and notices of facility self-certification. For the 11 months prior to the decision, only 105 applications and notices were filed.

tion 210(b) which states that rates shall be set so as not to "exceed incremental cost" of the electric utility. FERC Br. at 19. Relying on *Permian*, it characterizes its task as the establishment of a "zone of reasonableness" of which 100% of avoided cost is the upper limit. This reading misinterprets the statute and misapplies *Permian*. Congress explained that the rate should not exceed "the *lower* of the rate described above, namely a rate which is just and reasonable to consumers of the utility, in the public interest, and nondiscriminatory, *or* the incremental cost of alternate electric energy." Conf. Rep. *supra*, at 98, 1978 U.S. Code Cong. & Ad. News 7832 (emphases added). In other words, depending on the outcome of the "just and reasonable" determination, the "zone of reasonableness" might or might not include a rate which provided for 100% of avoided cost. The Commission's statutory error lies in its mistaken view that a 100% of avoided cost rate was *ipso facto* within the "zone of reasonableness," rather than a limit to be applied after the "just and reasonable" determination had been made.

As for *Permian*, it is clear that the Commission could set a rate at the high end of the "zone of reasonableness," but wherever it sets the rate, it must first have conducted an investigation of "representative evidence, ample in quantity to measure with appropriate precision the financial and other requirements of the pertinent parties." 390 U.S. at 769. Even given the PURPA conferees' concern that the examination not be as elaborate as that seen in the usual utility rate case, *see* p. 19 *supra*, the "zone of reasonableness" concept nonetheless requires *some* examination of the facts. This the Commission failed to do.

The American Paper Institute maintains that a full avoided cost rule is needed in order to give cogenerators leverage at the bargaining table and to induce the utility to bargain. API Br. at 26-29. In the utility industry's experience, state commissions are quite capable of applying these inducements, *see, e.g.*, Herron, *The Rush is on*

to Find New Gold in Falling Water, 13 Smithsonian 87, 90 (Dec. 1982) (California Pub. Utils. Comm'n assistance to small hydro company in negotiations), and do so regularly in other contexts, such as the review of utility resource plans or rates of return. Chairman Butler, who came to the Commission after these rules were promulgated, recently addressed this point. In a colloquy with Representative Moorhead of California, Chairman Butler stated:

> So the argument goes that in order to obtain a contract term adequate to support the financing, cogeneration must bargain with the utilities for something less than 100 percent of the avoided cost. Now, it has been represented that that is the case. The reason that I feel reluctant to either agree or not to agree is that . . . I simply have never seen any empirical evidence or even very much in the way of anecdotal evidence that supports the proposition.

Cogeneration and Small Power Production: Hearings on H.R. 6500, supra, at 17-18 (testimony of FERC Chairman Charles M. Butler III). Without evidence to support the argument of increased bargaining position, the "bargaining power" justification must fail.

API also claims that the long-term benefits to consumers are so great that no short-term rate benefits need to be granted to the consumer. API Br. at 23. Congress knew of long-term benefits such as "avoid[ing] the use of expensive electric energy generated by fossil fired units." Conf. Rep. *supra*, at 99, 1978 U.S. Code Cong. & Ad. News at 7833. Nonetheless, it required that rates be "just and reasonable," in addition to the long-term benefits expected to flow generically from cogeneration. API's argument impermissibly treats the "just and reasonable" clause as surplusage. *E.g., United States v. Menasche*, 348 U.S. 528, 538-39 (1955); 2A Sutherland, *Statutory Construction* § 46.06 (C. Sands 4th ed. 1973).

C. The Court of Appeals Responded Correctly to the Commission's Failure to Comply with the Statute

In this Court, the Commission has accused the Court of Appeals of "manifest hostility," "antagonism," "apparent distaste for the rule," and "substituting its judgment for that of the Commission." FERC Br. at 16-17, 21; *see also* API Br. at 15. Such contentions merit short shrift for two reasons. First, we believe it is entirely out of keeping with this Court's jurisprudence—including *Vermont Yankee Nuclear Power Corp. v. Natural Resources Defense Council, Inc.*, 435 U.S. 519 (1978)—to undertake, as the Commission has sought to do, FERC Br. at 17 n.17, to look behind the text on an appellate opinion in an effort to discern the court's motivation. Second, an examination of the Court of Appeals' decision (which sustained other challenged provisions of the Commission's cogeneration rules, *see* FERC Br. at 6 n.13; Pet. App. at B-34) demonstrates that, far from substituting its judgment for that of the agency, the court merely insisted that the agency "provide the public with the reasoned consideration, decisionmaking, and opinion which it is required to give," Pet. App. at B-12 (footnote omitted), rather than arbitrarily selecting a result that purports to encourage cogeneration without regard to cost or ratepayer benefit. The Commission has misread the court's opinion and displayed false modesty as to its ability to fulfill its responsibilities on remand. No corrective action by this Court is needed.

The Court of Appeals remanded on the full avoided cost issue, asking the Commission to explain what it did. Pet. App. at B-34. The court did not recommend a result to the Commission, and stated that "[t]he Commission may be right in its conclusion, but it needs to make its reasoning and findings explicit." *Id.* at B-11. The court took pains to point out that "[a] general rule is acceptable." *id.* at B-16, and added that the remand "would not necessarily require any inquiry into cogenerators costs." *Id.* at B-11. The court held only that "the Commission

must explain why the level was set here rather than somewhere else." *Id.* at B-16. In short, it dictated neither a result nor procedures.

This is hardly the work of a court bent on substituting its judgment for that of the agency.

The Commission states that "the court below appears to have relied on the rule of *Public Systems v. FERC*, 606 F.2d 973 (D.C. Cir. 1979), a case in which the court had applied a 'substantial evidence' test on review[.]" FERC Br. at 29. A close reading of both this case and *Public Systems* indicates that the "substantial evidence" test was not applied below. Rather, the Court of Appeals followed only the "reasoned decisionmaking" requirement of *Public Systems*. Pet. App. at B-12. As *Public Systems* itself observed, the "reasoned decisionmaking" standard is "similar to the standard enunciated recently . . . for 'arbitrary and capricious' review of informal rulemaking. . . ." 606 F.2d at 980 n.34. The mere citation of *Public Systems*, therefore, scarcely shows that the substantial evidence test was applied. More to the point, a review of the opinion below makes clear that the Court of Appeals was concerned with the inadequacy of the Commission's legal analysis and disregard of statutory requirements rather than with the inferences to be drawn from the record or the completeness of the record, although the latter are more typically associated with substantial evidence review.

The Administrative Procedure Act requires that agency action not be "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law." 5 U.S.C. § 706(2)(A) (1976). This standard of review does not allow an agency to ignore a statutory command, nor does it permit "judicial inertia which results in the unauthorized assumption by an agency of major policy decisions properly made by Congress." *NLRB v. Brown*, 380 U.S. 278, 292 (1965), *quoting American Ship Building Co. v. NLRB*, 380 U.S. 300, 318 (1965). Even under the "arbitrary and capricious" standard, an agency's

decision still must be "rational and based on consideration of the relevant factors." *FCC v. National Citizens Committee for Broadcasting*, 436 U.S. 775, 803 (1978). A statutory command is surely such a factor, since "a statute should be interpreted so as not to render one part inoperative." *Colautti v. Franklin*, 439 U.S. 379, 392 (1979). By disregarding Congress' explicit concern for electric consumer interests, the Commission doomed its action to invalidation under the arbitrary and capricious standard.

Finally, the filed briefs complain that the remand to the Commission will damage the cogeneration industry. One warns that the decision will frustrate the cogeneration program. Elizabethtown Gas Br. at 4. The Commission complains about "the several years' delay that would result from initiation of a new rulemaking" as a burden to the industry. FERC Br. at 34.[19] An industry group states that the Court of Appeals' action will "generally threaten the continued growth of electric power generation" through alternative means. Kerr-McGee Br. at 6-7. The lower court placed no burden on these parties other than to require that the Commission at least ask whether they are receiving a windfall at ratepayer expense. Despite the general economic decline, the co-

[19] There is no reason to believe that a prolonged period would be required to complete the proceedings on remand. Had the agency taken the necessary steps when the case was decided below, the new rules—assuming any changes were necessary—would probably be in place today. The Commission implies that the statutory deadline under which the rules were promulgated justifies unusual deference to its action. FERC Br. at 31 n.34. As it happens, the Commission missed the deadline. *Cf.* United States Steel Corp. v. EPA, 595 F.2d 207, 213 (5th Cir.) (agency could not have considered "sacrosanct" a deadline it missed), *rehearing granted in part on other grounds*, 598 F.2d 915 (5th Cir. 1979). In any event, the existence of such deadlines does not allow an agency to dispense with procedural requirements, *id.*, and *a fortiori* should not allow an agency to neglect a substantive requirement of law such as that which seeks to ensure rates that are "just and reasonable to electric consumers."

generation industry has prospered since the Court of Appeals' decision. Given the lack of adverse impact the Court of Appeals' action has had on cogeneration, and the Commission's failure to date to afford any recognition to the statutory goal of protecting consumer interests, the Court of Appeals' action has not "noticeably interfere[d] with," and will actually promote, the ends of PURPA. *Cf. New Jersey v. EPA*, 626 F.2d 1038, 1048 (D.C. Cir. 1980).

Any "just and reasonable" determination involves "a balancing of the . . . interests." *FPC v. Hope Natural Gas Co.*, 320 U.S. 591, 603 (1944). Given its dismissal of ratepayer interests, the Commission has yet to conduct the balancing process required under PURPA. Insisting that it do so is a quintessential judicial responsibility in our system of law.

CONCLUSION

For the foregoing reasons, the decision of the Court of Appeals should be affirmed.

Respectfully submitted,

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OCTOBER TERM, 1982

AMERICAN PAPER INSTITUTE, INC.,
Petitioner,
v.
AMERICAN ELECTRIC POWER SERVICE CORP., *et al.*,
Respondents.

FEDERAL ENERGY REGULATORY COMMISSION,
Petitioner,
v.
AMERICAN ELECTRIC POWER SERVICE CORP., *et al.*,
Respondents.

On Writs of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

BRIEF AMICI CURIAE OF KERR-McGEE CHEMICAL CORPORATION; SIMPSON PAPER COMPANY; UNITED TECHNOLOGIES CORPORATION, HAMILTON STANDARD DIVISION; AND COGENERATION SERVICES, INC.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1982

No. 82-34

AMERICAN PAPER INSTITUTE, INC.,
Petitioner,

v.

AMERICAN ELECTRIC POWER SERVICE CORP., *et al.*,
Respondents.

No. 82-226

FEDERAL ENERGY REGULATORY COMMISSION,
Petitioner,

v.

AMERICAN ELECTRIC POWER SERVICE CORP., *et al.*,
Respondents.

On Writs of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

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BRIEF AMICI CURIAE

INTEREST OF AMICI

Kerr-McGee Chemical Corporation ("Kerr-McGee"); Simpson Paper Company ("Simpson"); United Technologies Corporation, Hamilton Standard Division ("Hamilton Standard"); and Cogeneration Services, Inc. ("Cogeneration Services"), pursuant to Rule 36.2 of the Rules of this Court, respectfully submit this brief as amici curiae in support of petitioners Federal Energy Regulatory Commission ("FERC" or "the Commission") and the American Paper Institute, Inc. ("API"). Counsel for all parties have consented to the filing of this brief, and their consents have been filed with the Clerk of this Court.

Amici are companies that have responded to and relied upon the incentives for development of innovative and

renewable resource technologies created by the Public Utility Regulatory Policies Act of 1978, Pub. L. No. 95-617, 92 Stat. 3117 ("PURPA"), one of the five parts of the National Energy Act. Congress enacted section 210 of PURPA, 16 U.S.C. § 824a-3, specifically to encourage cogeneration [1] and small power production,[2] energy production processes in which Amici share a common interest.

Kerr-McGee is a cogenerator at three of its chemical manufacturing plants in the Searles Valley area of San Bernardino County, California. The company's Argus/Trona and Westend facilities produce bulk chemicals basic to the world-wide agricultural industry. Kerr-McGee's manufacturing processes require substantial quantities of steam for process evaporation and drying. This process steam is derived in a cogeneration mode through topping cycles which produce the electrical and mechanical power requirements of the three plants.

Kerr-McGee's Argus/Trona cogeneration system generates approximately 40 megawatts of electric power, as well as some 7,000 horsepower of mechanical power. All

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[1] Cogeneration is the sequential production of "electricity energy and steam or forms of useful energy (such as heat) which are used for industrial, commercial, heating, or cooling purposes." Federal Power Act § 3(18)(A) (as amended by § 201 of PURPA), 16 U.S.C. § 796(18)(A). Cogeneration increases the energy efficiency of industrial processes by enabling energy that formerly had been used to accomplish only one purpose to be used to accomplish two or more purposes. Simply put, more "work" is done per unit of energy input. If industries convert to cogeneration facilities on a wide enough basis, the contribution to the national effort to conserve nonrenewable fuels such as oil and natural gas will be enormous. *See* Wall St. J., Jan. 25, 1982, at 6, col. 2.

[2] A "small power production facility" produces electric energy "solely by the use, as a primary energy source, of biomass, waste, renewable resources, geothermal resources, or any combination" of these energy sources. Federal Power Act § 3(17)(A) (as amended by PURPA § 201), 16 U.S.C. § 796(17)(A). Small power producers, in other words, produce electricity entirely without the use of petroleum fuels.

of the electrical output of the Argus/Trona facility is currently used within the facility itself and, therefore, reduces the overall electric demand on Southern California Edison, its serving utility, by the amount generated. To advance the cogeneration goals of PURPA even further, however, Kerr-McGee has begun to expand the cogeneration capacity of the Argus/Trona facility to generate 6 megawatts of power over and above its needs, all of which is to be delivered to Southern California Edison for resale to its other customers. At Westend, Kerr-McGee generates, in addition to steam, an average of 12 megawatts of electricity for the facility's own use plus 3 to 5 megawatts of surplus power for use in the Southern California Edison system.[3]

Simpson is a diversified forest products and wood fiber manufacturing company with plants located principally on the West Coast.[4] Because steam is a major component of its pulp and paper manufacturing process and its wood drying process, Simpson has always had the capability to employ cogeneration technology to maximize the efficient use of energy at its plants. Before the enactment of PURPA, however, the lack of a ready market for, or of an economically adequate rate of return on, cogenerated electricity dissuaded Simpson from any substantial investment in cogeneration facilities. Following the enactment of section 210 of PURPA, Simpson has undertaken substantial commitments to new cogeneration facilities and has become a leader in business efforts to expand and modernize the industrial cogeneration facilities of this country.

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[3] On a straight useable output/heat input basis, the Argus/Trona cogeneration system has a thermal efficiency ratio of 86% as compared to the 34-37% efficiency ratio of a typical utility plant. The Westend system has a thermal efficiency ratio of 72%.

[4] Because Simpson is the wholly-owned subsidiary of Simpson Timber Co., the description that follows in text encompasses the activities of both these corporate entities.

Beginning with a pulp and paper mill in Anderson, California, Simpson is in various stages of planning, designing, and constructing six cogeneration facilities in California and Washington with a combined capacity of over 150 megawatts. The Anderson mill is a prime example of Simpson's efforts in this field. By June of 1983, the mill will convert from a conventional power system, with no electrical production capacity, to a natural gas-fired turbine/generator with a waste heat recovery boiler that is expected to generate an annual output of energy in excess of 260,000,000 kilowatt hours. Simpson has already contractually committed the Anderson mill to supply a major California utility, Pacific Gas & Electric Company, with 30 megawatts of capacity over the next thirty years. Simpson's efforts at Anderson are mirrored at its other cogeneration projects, and reflect Simpson's strong commitment to the cogeneration goals established by Congress in section 210 of PURPA.

Hamilton Standard is a long time designer, developer, and manufacturer of high technology products for the aerospace, automotive, and industrial markets. The company has recently expanded its activities to include the development of large (3 to 4 megawatt) wind turbine systems for the generation of electricity. Building from its existing technology base, Hamilton Standard has invested over $30 million in engineering design and in production facilities for the development of utility-scale wind turbine systems and has participated in the design and manufacture of two large wind turbine systems that are now operational. Hamilton Standard also has expanded its manufacturing facilities for wind turbine systems in order to provide wind energy systems to customers on a commercial basis. Hamilton Standard's strong commitment to wind energy derives from the market potential for wind energy systems in the United States fostered by PURPA and from a developing worldwide market for high technology energy products.

Cogeneration Services is a company that was founded to develop various types of alternative energy facilities. The company's objective is to own, operate, and finance cogeneration facilities in the forest product industry as well as small-scale hydroelectric projects. For example, through its ownership interest in another company, Cogeneration Services is currently engaged in the active development of small-scale hydroelectric sites in Colorado, Virginia, and the Northwest United States, among other areas of the country. In the cogeneration field, Cogeneration Services is working with a foreign boiler manufacturer to develop and finance the forest product industry's cogeneration capacity in the Northern Tier states. All of Cogeneration Services' vigorous efforts in the innovative and risky field of alternative energy were commenced in reliance on the economic incentives expressly provided by Congress in section 210 of PURPA to stimulate the development and expansion of cogeneration and small power production facilities. The work being done by Cogeneration Services in this field, however, is likely to be undermined, if not eliminated, if section 210 of PURPA is construed erroneously to diminish the incentives Congress intended to provide for alternative energy production.

Amici's efforts to develop and expand efficient electric generating capacity are threatened by the decision of the United States Court of Appeals for the District of Columbia Circuit vacating two key rules adopted by FERC to implement section 210 of PURPA. *American Electric Power Service Corp.* v. *FERC*, 675 F.2d 1226 (D.C. Cir. 1982), *reprinted at* Pet. App. B-1 to B-34.[5] The Commission's full avoided cost rule required utilities to offer to buy power from qualified cogenerators and small power producers at the utilities' "full avoided

[5] The opinions below and the orders of the Commission are reproduced in Appendix B to petitioner API's petition for a writ of certiorari in No. 82-34. Citations to these opinions and orders are to the appropriate page(s) of that appendix ("Pet. App.").

cost"—the incremental cost the utility would have incurred to acquire or to generate for itself the electricity provided by the qualifying facility. 18 C.F.R. § 292.304(b)(2). This rule had set at a high incentive level the rate cogenerators and other qualifying facilities would receive for the power they produced. The court of appeals also struck down the Commission rule that required electric utilities to interconnect with qualifying cogeneration and small power production facilities.[6] 18 C.F.R. § 292.303(c)(1). In its place, the court construed PURPA to require parties seeking interconnection orders to undergo a complex evidentiary hearing at the Commission. Pet. App. B-20 to B-25. This difficult procedure creates a lengthy obstacle course for those who seek to interconnect their cogeneration or small power production facilities with a neighboring utility.

Amici are only several of the many diverse companies that have responded to Congress' call for increased electric energy production through the expansion of the nation's cogeneration and small power production facilities. At the time of the court of appeals' decision, FERC had already received certification applications for cogeneration and small power production projects designed to produce 2.5 million kilowatts.[7] By 1995 FERC expected that cogeneration and small electric power production projects would produce as much electric energy as 15 nuclear power plants.[8] The decision of the court of appeals, if affirmed, would jeopardize the above efforts, including the plans of Amici and many others similarly situated for the construction, modernization, and enlargement of cogeneration and small power production facilities, and would, in fact, generally threaten the continued growth of electric power generation through the use of

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[6] Qualifying cogeneration facilities and qualifying small power production facilities will be referred to collectively throughout this brief as "qualifying facilities" or "QF's."

[7] *See* Wall St. J., Jan. 25, 1982, at 6, col. 2.

renewable resources—including wind, biomass, waste, and solar energy—and through more efficient use of non-renewable oil and natural gas. The climate of uncertainty created by the court of appeals' decision has cast a shadow over the development of a fledgling but vital new energy industry.

SUMMARY OF ARGUMENT

Congress enacted section 210 of PURPA specifically to encourage cogeneration and small power production and to remove the historic barriers that had inhibited their development. The full avoided cost and interconnection rules promulgated by the Commission are essential to the accomplishment of these statutory goals. For this reason, the court of appeals' judgment vacating these two rules should be reversed and the rules reinstated with full force and effect.

The Commission's full avoided cost rule was a valid and adequately explicated exercise of the Commission's experience and expertise in the area of electric power ratemaking. The court of appeals' decision to vacate the rule failed to accord the agency that deference to which its expert judgment is entitled. Moreover, because the court of appeals lacked the requisite economic expertise, it failed to appreciate that full avoided cost encourages increased electric energy production by efficient qualifying facilities in place of more expensive and less efficient generation by utilities. By so restraining, or even reducing, utility rates, full avoided cost clearly satisfies the statutory mandate that the rate set by the Commission be "just and reasonable to the electric consumers of the electric utility." 16 U.S.C. § 824a-3(b). Finally, a close examination of the reasons for the Commission's adoption

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[8] *Id.*; *cf.* Salisbury, "Court Ruling May Unplug Small Power Plants," *Christian Science Monitor* 7 (Feb. 10, 1982) (stating that applications for 3,000 megawatts of capacity have been presented to FERC pursuant to the cogeneration program).

of a full avoided cost rule, as stated in its accompanying opinion, reveals that FERC gave full and thorough consideration to all of the relevant interests specified by Congress in section 210 of PURPA.

The Commission's interconnection rule is likewise fully within FERC's statutory authority and, in fact, is absolutely essential to the agency's ability to implement the mandate of section 210(a) of PURPA. The Commission properly interpreted section 210(a) of PURPA to authorize the agency to order interconnection between utilities and qualifying facilities as a concomitant of its power to compel sales and purchases in this field. The court of appeals' interpretation of section 210(e)(3)(B) to preclude the Commission from authorizing interconnection by rule in the area of cogeneration and small power production ignores the overriding statutory intent of Congress and fails to give adequate deference to the Commission's reasonable interpretation of its organic statute.

ARGUMENT

I. THE FULL AVOIDED COST RULE IS AUTHORIZED BY PURPA, FULLY CONSISTENT WITH THE ACT, AND ESSENTIAL IF THE POLICIES ADOPTED BY CONGRESS ARE TO BE IMPLEMENTED.

The court of appeals vacated the Commission regulation that required utilities to pay cogenerators and other eligible sellers the utilities' full avoided cost for purchases of power. The court of appeals held that the Commission had not adequately explained and justified its decision to set the compensation due cogenerators at full avoided cost rather than at some lower amount. Pet. App. B-18. As commentators have noted, the court of appeals did not reach a neutral conclusion, but rather "appeared to favor the issuance of a rule allowing cogenerators to charge a percentage of the utilities' avoided

cost."[9] The court of appeals' decision is flawed both legally and in the economic analysis that underlies its rationale for vacating the rule as inadequately explained.

More fundamentally, the court failed to apply a properly deferential standard of review, erroneously substituting its economic theories for the technical expertise of the Commission, and refusing to respect what is, both objectively and in context, an entirely adequate explanation of the Commission's rationale. As this Court stated in *Gainesville Utilities Department* v. *Florida Power Corp.*, 402 U.S. 515 (1971), "the guidepost here is the Act's explicit commitment of the judgment as to what compensation is reasonably due, in this highly technical field, to the Commission." *Id.* at 528.[10] For these reasons, as amplified below, the opinion of the court of appeals should be reversed.

A. The Court of Appeals Did Not Give Proper Deference to FERC's Technical Expertise in the Establishment of Full Avoided Cost As the Appropriate Rate For Purchases of Power from Qualifying Generators.

The court of appeals found that FERC had not "adequately justified," "made clear," or "explained" how the full avoided cost rule is consistent with section 210(b) of PURPA. Finding the reasons given by FERC for adoption of the rule "inadequate," the court held that the Commission had failed "to meet its obligation to provide the public with the reasoned consideration, decision-making, and opinion which it is required to give." Pet. App. B-9 to B-12. Like beauty, what is an "adequate"

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[9] Strohl, Jr., "D.C. Circuit Decision Increases Uncertainty About Regulatory Treatment of Cogeneration," 14 *Nat. Resources L. Newsletter* 4, 5 (Spring 1982).

[10] The Court in *Gainesville Utilities*, 402 U.S. 515, also took pains to emphasize the Federal Power Act's injunction in section 313(b), 16 U.S.C. § 825*l*(b), that "the finding of the Commission as to the facts, if supported by substantial evidence, shall be conclusive." *Id.* at 527.

explanation lies in the eye of the beholder. The court of appeals, distracted by its perception of the greater attractiveness of a percentage of avoided cost rate, as compared to a full avoided cost rate, asked far more of the Commission than the Administrative Procedure Act and the decisions of the Court require.

Section 210 of PURPA imposes no procedures for the promulgation of rules under its authority beyond the informal rulemaking procedures prescribed by the Administrative Procedure Act, 5 U.S.C. § 553.[11] The Commission's rules need therefore be accompanied only by "a concise general statement of their basis and purpose", and not, as would be the case were this an adjudication or formal rulemaking, by "findings and conclusions, and the reasons or basis therefor, on all the material issues of fact, law, or discretion presented on the record." 5 U.S.C. § 557(c)(3)(A). *See National Nutritional Foods Association* v. *Weinberger*, 512 F.2d 688, 701 (2d Cir.), *cert. denied*, 423 U.S. 827 (1975); *Mobil Oil Corp.* v. *FPC*, 469 F.2d 130, 139-40 (D.C. Cir. 1972), *cert. denied*, 412 U.S. 931 (1973).

The "concise general statement of basis and purpose" required by the APA must, of course, be "reasoned." But "reasoned decisionmaking" does not consist of belabored explication of the facts and opinions that underlie an agency's choice of policy. Particularly in complex, technical, and uncertain areas and in the construction of newly enacted statutes, the requirement of reasoned decisionmaking is a mandate that the agency take a hard

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[11] Section 210 of PURPA directs FERC to provide "a reasonable opportunity for interested persons . . . to submit oral as well as written data, views and arguments" before issuing its cogeneration and small power production rules, but this requirement does not affect the applicability of the APA's informal rulemaking provisions. *See United States* v. *Florida East Coast Ry.*, 410 U.S. 224 (1973); *United States* v. *Allegheny-Ludlum Steel Corp.*, 406 U.S. 742 (1972).

and fair-minded look at the problems posed by the statute; show a willingness to listen and respond to constructive comments; and make an honest, unbiased effort to judge where the public interest lies.[12]

Although the court of appeals' opinion on the full avoided cost standard refers repeatedly to the inadequacy of FERC's explanation of the standard, the court below did not seriously attempt to conceal its belief that the agency's understanding of the problem was simply wrong—wrong because the Commission's considered judgment differed from the court's own conclusions on the proper rate that utilities ought to pay for power produced by cogenerators and small power producers. *See* Pet. App. B-12 to B-16. Amici believe, for reasons stated below, that the court of appeal's unsupported assertions about the nature of the market for QF-generated power and the effect on electric consumers of rates set at full avoided cost are manifestly incorrect. The question, however, is not whether the Commission or the court of appeals is correct about the nature of the market for QF-generated power, because Congress vested the Commission with the authority to make determinations of

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[12] Judge Leventhal, quoting from and using this Court's decision in *Mobil Oil Corp.* v. *FPC*, 417 U.S. 283 (1974), as an example, captured both the requirement and its rationale:

> The parties raised a not insubstantial issue. The Court's response identified the context that the Commission had taken "massive evidence" with voluminous exhibits and various cost estimates in the record, and that the rates fixed, even with incentive increments, were within the range of cost estimates. "Its difficulties, while not minor, did not stem from any failure to seek answers." That single sentence is a capsule of the requirement of reasoned decisionmaking in the context of the novel and exigent problem of seeking to enhance natural gas supply in time of dire shortage while maintaining fairness to consumers.

American Pub. Gas Ass'n v. *FPC*, 567 F.2d 1016, 1030 (D.C. Cir. 1977) (quoting *Mobil Oil Corp.* v. *FPC*, 417 U.S. at 318), *cert. denied*, 435 U.S. 907 (1978).

that type subject only to the limited scope of review set forth in the Administrative Procedure Act, 5 U.S.C. § 706(2)(A). As section 706(2)(A) states: "The reviewing court shall . . . hold unlawful and set aside agency action, findings, and conclusions found to be . . . arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law." *See Citizens to Preserve Overton Park, Inc.* v. *Volpe*, 401 U.S. 402, 416 (1971); *Vermont Yankee Nuclear Power Corp.* v. *Natural Resources Defense Council, Inc.*, 435 U.S. 519, 558 (1978).

This deference to Commission expertise is especially pronounced in the field of energy rate-setting:

> Congress has entrusted the regulation . . . to the informed judgment of the Commission, and not to the preferences of reviewing courts. A presumption of validity therefore attaches to each exercise of the Commission's expertise, and those who would overturn the Commission's judgment undertake "the heavy burden of making a convincing showing that it is invalid because it is unjust and unreasonable in its consequences." We are not obliged to examine each detail of the Commission's decision; if the "total effect of the rate order cannot be said to be unjust and unreasonable, judicial inquiry under the Act is at an end." . . . [The Commission] must be free, within the limitations imposed by pertinent constitutional and statutory commands, to devise methods of regulation capable of equitably reconciling diverse and conflicting interests.

Permian Basin Area Rate Cases, 390 U.S. 747, 767 (1968) (citation omitted).

Respect for the FERC's judgment in this case is heightened by the one-year deadline imposed on FERC by Congress;[13] the fact that the rules represent the con-

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[13] *See Weyerhauser Co.* v. *Costle*, 590 F.2d 1011, 1026 (D.C. Cir. 1978) ("[u]nless we are quite certain of our basis for doing so,

struction of a new statute by its implementing agency;[14] the recognition that "the breadth of agency discretion is, if anything, at its zenith when the action . . . relates primarily not to the issue of ascertaining whether conduct violates the statute, or regulations, but rather to the fashioning of policies;"[15] the general rule that "when regulation features novelty in subject, technique, or both, the narrow scope of review established by conventional doctrine is further circumscribed;"[16] and the view that when, as here, administrative decisions "rest on judgment and prediction rather than pure factual determinations . . . . complete factual support for the Commission's ultimate conclusions is not required, since 'a forecast of the direction in which future public interest lies necessarily involves deduction based on the expert knowledge of the agency.'"[17]

Moreover, in the text of the statute, Congress empowered the Commission to adopt a full avoided cost rate, as well as a lesser rate: "No rule prescribed under subsection (a) shall provide for a rate which exceeds the incremental cost to the electric utility of alternate elec-

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we must be slow to overturn the Agency's judgment, whichever way it may incline, when Congress has required it to act quickly and decisively despite the lack of exact data").

[14] *See National Muffler Dealers Ass'n* v. *United States*, 440 U.S. 472, 477 (1979) ("A regulation may have particular force if it is a substantially contemporaneous construction of the statute by those presumed to have been aware of congressional intent"); *Udall* v. *Tallman*, 380 U.S. 1, 16 (1965); *Power Reactor Dev. Co.* v. *Int'l Union of Elec., Radio and Mach. Workers*, 367 U.S. 396, 408 (1961).

[15] *Tennessee Gas Pipeline* v. *FERC*, 606 F.2d 1094, 1120 n.96 (D.C. Cir. 1979) (quoting *Niagara Mohawk Corp.* v. *FPC*, 379 F.2d 153, 159 (D.C. Cir. 1967)), *cert. denied*, 445 U.S. 920 (1980).

[16] *American Pub. Gas Ass'n* v. *FPC*, 567 F.2d 1016, 1031 (D.C. Cir. 1977), *cert. denied*, 435 U.S. 907 (1978).

[17] *FCC* v. *WNCN Listeners Guild*, 450 U.S. 582, 594-95 (1981) (quoting *FPC* v. *Transcontinental Gas Pipe Line Corp.*, 365 U.S. 1, 29 (1961)).

tric energy." PURPA § 210(b), 16 U.S.C. § 824a-3(b). Because the full avoided cost rate is therefore presumptively within a zone of reasonableness established by Congress, the Commission's choice of a rate admittedly within that zone must be regarded as committed to its broad discretion.

In short, the circumstances surrounding FERC's adoption of the full avoided cost rule justified the greatest possible deference by the court of appeals. The court chose instead to substitute its views for those of FERC.

B. The Full Avoided Cost Rule is Just and Reasonable to Utility Customers, Who Will Reap Substantial Economic Benefits From the Commission's Decision to Require Utilities to Purchase Power from Qualifying Facilities at Full Avoided Cost.

The full avoided cost rule establishes a rate—the rate due cogenerators and small power producers for the electricity they produce and sell to a purchasing utility. The reason for the court of appeals' dissatisfaction with the full avoided cost standard stems from the court's belief that the rule, as explained by the Commission, failed to satisfy one prong of the statutory requirements: the mandate that the rate be "just and reasonable to the electric consumers of the electric utility." PURPA § 210(b)(1), 16 U.S.C. § 824a-3(b)(1). Viewing the just and reasonable standard as requiring a balancing of interests, the court concluded that the Commission had given all of the benefits of cogeneration and small power production to QF's and none to utility customers. In reaching its conclusion, the court developed its own economic analysis of the consequences of the full avoided cost standard upon utilities' customers. *See generally* Pet. App. B-12 to B-17. But the analysis is fundamentally flawed, as shall be demonstrated, and may be so flawed because the court of appeals lacked the Commission's basic understanding of the fundamental charac-

teristics of electric utility generation. The understanding that the Commission has developed through years of experience, and that the court of appeals lacks, is the foundation of the doctrine of deference to agency expertise. There is no better case for its application than the instant one.

Under the familiar statutory standard of "just and reasonable," the result reached, not the method employed, is determinative. *FPC* v. *Hope Natural Gas Co.*, 320 U.S. 591, 602 (1944). The impact of the rate order, not its theoretical basis, controls. If the "total effect of the rate order cannot be said to be unjust and unreasonable, judicial inquiry under the Act is at an end." *Id.* As we shall demonstrate, the effect of the Commission's full avoided cost rate is just and reasonable to electric consumers. In no way would electrical consumers be worse off under a full avoided cost rule and, in fact, they would likely be better off over time as cogeneration develops and takes hold.

What the court of appeals misapprehended is the relationship between the power produced by qualifying facilities and the utility generated power it replaces. A basic tenet of utility economics is that increased electric energy production by efficient nontraditional suppliers of electric energy will replace more expensive and less efficient incremental generation by utilities and will help to avoid or defer new generating capacity. The long term result of these effects will be to restrain or even reduce utility rates and to yield direct savings to utility customers.

The impact of cogeneration and small power production on utility rates is illustrated in Figure I, attached as Appendix A, which plots electricity generated (in megawatts) against its average cost plus rate of return (in cents per kilowatt hour (kwh)) for a hypothetical electric utility. Point A represents the utility's current generation at a particular point in time—2,500 megawatts at an average cost (plus rate of return) of 6 cents per

kwh. If one assumes—as AEP has argued would be the case—that cogeneration and small power production together will produce 20 percent of the utility's load, *see* Petitioner's Brief at 28 n.25, *American Electric Power Service Corp.* v. *FERC*, 675 F.2d 1226 (D.C. Cir. 1982) ("AEP's App. Brief"), the utility's power production will be reduced to 2000 megawatts, point B on the curve. More importantly, both the utility's marginal cost (which is virtually equivalent to the operating cost element of its full avoided cost) and its average cost plus return—*i.e.*, its rates—will be lowered to 4 cents per kwh. Indeed, because the utility's marginal or avoided cost has declined, the rates payable to QF's under the Commission's rules will also fall.

In short, the substitution of electricity generated by qualifying facilities for the utility's most expensive electricity reduces average costs and therefore the rates paid by utility customers. The numbers used are fictional, but the point of the example will be valid so long as a utility faces the common condition of the electric utility industry today: increasing marginal costs with increased power generation.[18] This assumption is supported by the Utilities' own discussion of the high cost of peak load generation before the court of appeals, *see* AEP's App.

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[18] The average price of electricity sold in the United States to end-users has climbed steadily and sharply since 1973, *see* Energy Information Adm'n, United States Dep't of Energy, *1980 Ann. Report to Congress* 170 (1981). The analysis holds true whether electricity is priced on an average cost or a marginal cost basis. Indeed, if marginal cost pricing (which is encouraged by PURPA) is employed, the savings will be much greater because marginal cost increases faster than average cost when costs are rising and decreases faster than average cost when costs are falling. The assumption essential to the analysis—that the marginal (and therefore the average) cost of electricity increases as more power is produced—holds true so long as utilities employ their lowest-cost capacity first. *See* Energy Information Adm'n, United States Dep't of Energy, *1977 Ann. Report to Congress* 205 (1978) ("1977 EIA Report").

Brief at 44-46, and is consistent with the practice of electric utilities to use lower cost capacity first, and to bring higher cost capacity on line only as needed, and then in order of increasing cost.[19]

A portion of the cost savings demonstrated above will be realized almost immediately, as utilities simply reduce usage of their most expensive peak load capacity.[20] Over the long term, the savings—and therefore the rate reductions—will be much greater. To the extent that QF's proliferate and produce power during peak periods as a result of the incentives provided by PURPA and the Commission's regulations, utility requirements for expensive and inefficient generating peak load capacity will be greatly reduced. This reduction in turn will lower both the high operating costs associated with peaking units[21] and the capital costs incurred to install new capacity, both of which are passed on to consumers in the rates charged by utilities. *See Re Cogeneration & Small Power Production*, 47 Pub. Util. Rep. 4th (PUR) 327, 332-33 (Maine Pub. Util. Comm'n July 9, 1982); *Re Cogeneration and Small Power Production*, No. U-6798, slip op. at 14-16 (Mich. Pub. Serv. Comm'n Aug. 27, 1982) (observing that generation and small power production facilities will "encourage the development of dispersed power generation which is clearly beneficial to all of a utility's ratepayers since it can delay the construction of larger, more costly generating facilities"); *Re Consolidated Edison Co.* 48 Pub. Util. Rep. 4th (PUR) 94, 109 (N.Y. Pub.

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[19] 1977 EIA Report, *supra* note 18, at 205-206.

[20] This capacity typically uses high cost gas or oil. *See* 1977 EIA Report, *supra* note 18, at 205.

[21] As the Utilities noted in their brief before the court of appeals, AEP's App. Brief at 46 n.41, peak units are most likely to run on scarce oil and natural gas. Replacement of utilities' peak load generation with more efficient QF's will thus have the additional benefit of conserving these more costly resources. The savings that ensue will reduce inflationary pressure on rates and will result in long run cost reductions to utilities and their customers.

Serv. Comm'n May 12, 1982) (requiring utility to purchase QF-generated power at full avoided cost "should lead to long-run savings for both utilities and ratepayers").[22]

Absent artificial barriers to entry,[23] cogenerators and small power producers will enter the market or increase their capacity as long as the full avoided cost of the utility in whose service area they are located (*i.e.*, as long as the price they receive) exceeds their marginal cost of production. As more cogeneration and small power producers come on line, however, the utility's full avoided cost will decline. Eventually, the market will reach equilibrium: when the marginal cost of constructing or expanding a qualifying facility equals the utility's avoided cost, the growth in qualifying facilities will stop. At that point, electric consumers will have reaped all of the economic benefits of cogeneration and small power production, because marginal qualifying facilities will be receiving no more than their costs plus a return (equal to the cost of money) on their investment. If—and only if—utility purchase rates are set at utility full avoided costs, consumer rates for electric power will be minimized over the long term.

These savings will obviously benefit utility customers, but reduced investment and lower costs are not popular with utilities. For reduced investment means a lower rate base, and a smaller rate base means smaller dollar "profits." For this reason, among others, utilities often resist policies that encourage cogeneration and small power pro-

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[22] The concern of the court of appeals that the full avoided cost standard may cause utilities with excess capacity to charge higher rates to the remaining customers is misplaced. In its Order, the Commission considered the question of excess capacity in adopting a definition of full avoided cost. *See* Pet. App. B-44 to B-45. The court also ignored the utilities' flexibility in decommissioning or retiring high cost or antiquated units so as to reduce excess capacity.

[23] For example, the inability to obtain interconnection without lengthy and expensive hearings. *See* section II.B.3, *infra*.

duction.[24] As the Court noted last term, Congress recognized, in adopting PURPA's remedial provisions, that "traditional electric utilities were reluctant to purchase power from, and to sell power to, the nontraditional facilities." *FERC* v. *Mississippi*, 50 U.S.L.W. 4566, 4568 (U.S. June 1, 1982). Congress did not make the mistake of equating the interests of utilities with the interests of their customers, however, and the Court should not do so. The interests of utility customers will be served by the provision of reliable electric power service at the lowest possible cost, as Congress intended, not by the discouragement of rate-reducing alternatives to utility generation.

In sum, expansion of QF capacity, which would be maximized by the full avoided cost rate, will allow utilities to (a) avoid new capacity, (b) eliminate or phase out less efficient, high-cost capacity, and (c) use inefficient capacity less often. All three effects reduce utility capital and operating costs, and thus consumer rates, from what they otherwise would be. Because of these benefits, the full avoided cost rule will reduce electric consumer rates to a greater degree (in the long run) than any other rate. The rule is manifestly just and reasonable.[25]

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[24] *See, e.g.*, Decision 91109, Investigation on the Commission's Own Motion Into the Electric Resource Plan and Alternatives of Pacific Gas and Electric Company, O.I.I No. 26 (Cal. Pub. Util. Comm'n December 19, 1979) (*"California PUC Decision 91109, OII-26"*). In that proceeding, the California P.U.C. found that, despite the recognized benefits of cogeneration, Pacific Gas and Electric had failed to staff itself adequately to pursue cogeneration, to plan for cogeneration, to approach large potential cogenerators, or in general to implement California P.U.C. policies designed to encourage cogeneration.

[25] The benefits of cogeneration and small power production, however, are not limited to rate reduction. First, small power production reduces the nation's dependence on oil and gas. *See generally FERC* v. *Mississippi*, 50 U.S.L.W. at 4568-4570 ("electricity consumed more than 25% of the total energy resources used in this country while supplying only 12% of the user demand for energy"). Cogeneration produces similar benefits because the process permits more useful work per barrel of oil or per cubic foot of natural gas. *See* note 1 *supra*. Second, alternative generating sources diversify

C. The Commission More Than Adequately Explained the Rationale for Its Decision in Full Compliance With the Administrative Procedure Act.

Measuring the Commission's explanation by the deferential standard required in an area of ratemaking consigned to the Commission's expertise under a novel regulatory statute, and placing aside the erroneous, theoretical objections that the court of appeals found with the economics of the full avoided costs standard, the Commission's Order should be upheld.

The Commission dealt extensively with the "split-the-savings" approach because a number of interested persons advanced this methodology as the principal alternative to a full avoided cost rule. After extensively discussing the split-the-savings approach, the Commission went on to consider the percentage of avoided cost approach—the method favored by the court of appeals on the basis of its misconceived economic theory. The Commission's discussion of percentage of avoided cost must be viewed in the context of its extensive preceding discussion concerning the split-the-savings approach and its discussion of incremental cost. *See* Pet. App. B-43 to B-45; B-63 to B-66.

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a utility's resource plan, and, therefore, increase system reliability. *California PUC Decision 91109, OII-26, supra* note 24, at 13. Third, because reserve margins are often established to replace an unplanned outage of the largest power plant on line, the development of many small power plants reduces reserve requirements by reducing the probability of a large outage. *Id.* at 14; *see also Gainesville Utilities Department* v. *Florida Power Corp.*, 402 U.S. 515, 518 n.2 (1971). Fourth, the lead time required for cogeneration is several years less than that needed to plan and construct large central station nuclear power plants—2 to 5 years, as opposed to 10 to 15 years. Development of cogeneration facilities therefore allows greater flexibility in resource planning. *Id.* Fifth, because QF's are paid only for actual power generated, utility ratepayers bear none of the costs of unscheduled outages. *Id.* Finally, many forms of small power production (*e.g.*, geothermal, wind power, and solar power) are less polluting than the combustion processes employed in the utility peaking facilities they replace.

In reaching its decision to adopt a full avoided cost rate, the Commission focused on the statutory purpose and found that a percentage of avoided cost rate—the approach favored by the court of appeals—would provide less than the maximum permissible incentive to cogeneration and small power production. This focus, of course, fulfills the overall congressional design to encourage cogeneration and small power production. *FERC* v. *Mississippi*, 50 U.S.L.W. at 4568. But the Commission did not limit its focus solely to the consideration of the best way to implement this congressional purpose. Recognizing that Congress intended consumer interests to be considered, the Commission also examined the impact the competing rate approaches would have on electrical consumers and concluded that a full avoided cost rate would in no way harm the customers of utilities. The Commission reasoned that consumers of electricity would be kept whole because the price at which they purchased electricity would not rise yet they would enjoy the benefits of lesser dependence on imported oil and of more efficient use of energy attributable to cogeneration and small power production. Pet. App. B-65. As the Commission observed, these latter benefits are maximized because of—not in spite of—the full avoided cost rule and its provision of the maximum incentive to development of cogeneration. *See* Pet. App. at B-65 to B-66.

Contrary to the court of appeals' conclusions, therefore, the Commission did consider both the impact on consumers [26] and the public interest [27] in its decision and only

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[26] The Commission concluded that the rate reducing impact of a percentage savings approach would be "insignificant" per individual customer. The court of appeals took exception to this conclusion even though the statement appears obvious (even without a bow to the technical expertise of the agency). Utilities in large metropolitan areas serve hundreds of thousands, if not millions, of customers. If cogeneration sources ultimately represent 20 percent of the "supply" of the utility, the overall effect of an 80 percent avoided cost standard would be that at most 4 percent of the *incremental* cost of

then chose to strike a balance at the maximum incentive to cogeneration and small power production. Because the Commission expressly considered the impact of its Order on electric consumers, on the public interest, and on cogenerators and articulated its rationale for the selection of the maximum incentive rate of compensation within the zone of reasonableness permitted by Congress, the Commission's exercise of its discretion must be affirmed.

II. THE COURT OF APPEALS' RULING THAT PURPA DOES NOT AUTHORIZE THE COMMISSION TO ADOPT RULES REQUIRING UTILITIES TO INTERCONNECT WITH QUALIFYING FACILITIES IS ERRONEOUS AND SHOULD BE REVERSED.

FERC's cogeneration and small power production rules direct "any electric utility", with minor exceptions, to "make such interconnections with any qualifying facility as may be necessary to accomplish purchases or sales under this subpart." 18 C.F.R. § 292.303(c)(1). The court of appeals struck this rule on the ground that section 210(e)(3)(B) of PURPA prohibited the Commission from authorizing interconnections between qualifying facilities and utilities except on a case-by-case basis in compliance with the procedures and criteria mandated by sections 210 and 212 of the FPA, 16 U.S.C. §§ 824i & 824k.

The court of appeals' conclusion as to the FERC's authority to issue the interconnection rule is erroneous. The rule is within FERC's statutory authority and, indeed, is absolutely essential if Congress' mandate—which respondents characterized before the court of appeals as a mandate for "the Commission [to] remove institutional barriers to efficient cogeneration" [28]—is to be carried out.

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generation would be "saved." Only this small amount would be spread among the very large class of ratepayers.

[27] These included decreased reliance on scarce fossil fuels, more efficient use of energy, and a higher growth rate for new technologies. *See* Pet. App. at B-65 to B-66.

[28] AEP's App. Brief at 47.

Even if section 210 of PURPA is arguably ambiguous as to FERC's authority to order interconnection by rule, the Commission's resolution of that ambiguity in favor of an interpretation that carries out the essential purposes of the statute is entitled to substantial deference.

A. On Its Face, the Commission's Authority to Issue Rules Requiring Purchases and Sales of Electricity Includes the Power to Mandate Interconnection.

All the parties agree that PURPA directs the FERC to issue rules requiring utilities to offer to sell electricity to, and buy electricity from, qualifying facilities. Because there can be no purchases or sales, as mandated by the Act and the rules, absent interconnection between utilities and qualifying facilities, the lower court's conclusion that FERC lacks authority under section 210(a) of PURPA to order interconnection by rule collapses of its own weight.[29] If the Commission is to issue rules that require utilities to transfer ownership of, and title to, electricity to QF's, the Commission must of necessity have the authority to adopt a companion rule that requires the physical connections necessary to permit the current to follow the title and flow between utilities and qualifying facilities. Without this essential authority, the "purchases" and "sales" that the Commission could order would involve transfer of ownership without transfer of power—a result totally at odds with the intent behind the statute.

To avoid so great a frustration of congressional intent, the Commission therefore construed its authority under section 210 of PURPA to encompass the power to order interconnection:

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[29] The Utilities themselves argued to the court of appeals that "purchase" and "sell" are to be defined literally. They contended that the Commission was "limited to issuing rules requiring utilities to engage in 'purchases,' 'sales,' and 'exchanges' as those words are understood in their ordinary and common meanings." AEP's App. Brief at 35. AEP argued that the word "sale", for example, meant "the transfer of ownership of and title to property from one person to another for a price." *Id.*

> [T]he obligation to interconnect with a qualifying facility is subsumed within the requirement of section 210(a) that electric utilities offer to sell electricity to and purchase electricity from qualifying facilities. . . . [T]o hold otherwise would mean that Congress intended to require that qualifying facilities go through the complex procedures [of sections 210 and 212 of the FPA] simply to gain interconnection, contrary to the mandate of section 210 of PURPA to encourage cogeneration and small power production.

Pet. App. at B-58; *see also* Pet. App. at B-60.

In light of the practical need to equip FERC with the power to order interconnections to effectuate congressional intent, the Commission's interpretation of section 210 of PURPA is the correct one as a matter of statutory interpretation. Consequently, the court of appeals' decision that the Commission lacks the essential authority to order interconnection by rule should be reversed.

B. Sections 210 and 212 of The Federal Power Act, as amended, Do Not Limit the Commission's Authority to Order Interconnection by Rule.

The court of appeals relied almost exclusively on section 210(e)(3)(B) of PURPA to support its conclusion that FERC is precluded from ordering interconnection except on a case-by-case basis, after an evidentiary hearing that must be conducted if the relevant utility so requests.

Even if this conclusion is considered a plausible interpretation of section 210 of PURPA, the court nevertheless erred by substituting its interpretation for the at least equally reasonable interpretation given the statute by the Commission. The court once again exceeded the proper scope of review by failing to accord the Commission's interpretation of its own statutory authority the appropriate degree of deference. This Court has very recently explained the appropriate role of the courts of appeal in

reviewing an agency's construction of its governing statute:

> [T]he task of the Court of Appeals [is] not to interpret the statute as it [thinks] best but rather the narrower inquiry into whether the [agency's] construction [is] "sufficiently reasonable" to be accepted by a reviewing court. To satisfy this standard it is not necessary for a court to find that the agency's construction [is] the only reasonable one or even the reading the court would have reached if the question initially had arisen in a judicial proceeding.

FEC v. *Democratic Senatorial Campaign Committee*, 454 U.S. 27, 39 (1981) (citations omitted); *accord Udall* v. *Tallman*, 380 U.S. 1, 16 (1965). Employing appropriate canons of statutory construction to resolve the purported conflict between subsections (a) and (e) of section 210 of PURPA, the court of appeals should have concluded that FERC's interpretation is not simply "sufficiently reasonable," but is compelling.

1. ***Sections 210 and 212 of the FPA Need Not Override Section 210 of PURPA to Play an Important Statutory Role.***

With a dearth of analysis, the court of appeals assumed that qualifying facilities under section 210 of PURPA were in fact subject to the substantial regulatory burdens imposed by sections 210 and 212 of the FPA. In contrast, the Commission, after a careful statutory analysis sensitive to the purposes behind the respective provisions, concluded that sections 210 and 212 of the FPA did not prevent the agency from promulgating a general interconnection rule designed to implement the specific mandate of section 210 of PURPA.

As explained at length by the Commission in its Rehearing Order, Congress intended sections 210 and 212 of the FPA to promote, not to impede, interconnection. *See* Pet. App. B-179 to B-182; *accord FERC* v. *Missis-*

sippi, 50 U.S.L.W. at 4568, 4570. To achieve that end, the conferees, altering the Bill in which these sections originated, "extended the right to apply for interconnection orders to certain cogenerators and small power producers." S. Rep. No. 1292, 95th Cong., 2d Sess. 90 (1978).[30] The conferees' statement is convincing evidence that Congress did not enact sections 210 and 212 of the FPA to permit utilities to frustrate cogeneration and small power production by compelling QF's to suffer time-consuming and expensive hearings on every interconnection, but rather intended that these sections, like section 210 of PURPA, be used to *advance* cogeneration and small power production. The meaning that the court below gave the "no exemption" clause of PURPA § 210 is flatly inconsistent with this intent.

The court of appeals also erroneously concluded that FERC's interpretation of the "no exemption clause" of section 210 of PURPA would render section 210(e)(3)(B) "meaningless surplusage." Pet. App. B-24. The conclusion was based on the court's rejection of the Commission's reasonable attempt to reconcile section 210(e)(3)(B) and section 210(a) of PURPA. Under the Commission's construction, Section 210(a) gives FERC the authority to order interconnection by rule when a qualifying facility sought to sell to and purchase from a utility in accordance with the mandate of Congress. Section 210(e)(3)(B), in turn, empowers FERC to order a qualifying facility to interconnect when the facility is *the target* of a utility's—or perhaps another qualifying facility's—efforts to interconnect. Pet. App. B-180 to B-182. With this sensible harmonization of the two provisions, the Commission as-

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[30] In fact, the primary purpose of sections 210 and 212 of the FPA was to remedy interconnection disputes among utilities in Texas and surrounding states. The sections were intended to permit interconnection of these utilities without subjecting them to the full panoply of federal regulation. *See* 123 Cong. Rec. S16,376 (daily ed. Oct. 5, 1977) (Col. 1, 2, & 3) (remarks of Sen. Johnston); *Id.* S16,377 (Col. 1, 2) (colloquy Sens. Bartlett and Johnston).

sured itself of the authority needed to accomplish Congress' directive to encourage the efforts of qualified facilities and ensured that, if the need arose, QF's could be the subjects of, and not merely applicants for, interconnection orders.[31]

2. *PURPA § 210 and FPA § 210 Orders are not Mutually Exclusive*

Sections 210 and 212 of the FPA authorize the Commission to issue adjudicative orders upon application, while section 210 of PURPA requires the agency to issue rules on its own motion.[32] This discrepancy is hardly unprecedented; many federal agencies are authorized to use both adjudication and rulemaking to implement regulatory policy. Congress may have enacted the "no exemption" clause of section 210(e)(3)(B) of PURPA and the "no limitation" clause of section 212 of the FPA to prevent FERC from limiting its choices and foreclosing action in either manner. To construe the "no exemption" clause to *require* the Commission to hold a full-dress hearing before mandating interconnection every time a utility refuses to interconnect with a QF voluntarily, however, is senseless and is at odds with the thrust of PURPA. In the oft-quoted words of this Court, "the choice made between proceeding by general rule or by individual, *ad hoc* litigation is one that lies primarily in the informed discretion of the administrative agency." *SEC* v. *Chenery Corp.*, 332 U.S. 194, 203 (1947).

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[31] For example, a QF located in an area served by a utility with low marginal (*e.g.*, avoided) costs might prefer to interconnect with a nearby utility having high marginal costs and a shortage of capacity. In such a case, the QF would want to participate in, and be subject to, an interconnection order requiring the nearby utility to interconnect to the QF and wheel power to the distant utility.

[32] The Court should note that, though the Commission rules direct utilities to interconnect with QF's, 18 C.F.R. § 292.303(c), QF's must bear the cost, 18 C.F.R. § 292.306. FERC left to state regulatory commissions the determination of what costs of interconnection are reasonable.

Congress was all too familiar, when it enacted PURPA, with the delay and expense of administration adjudication. The ambiguity of the statute should not be resolved in a way that denies the Commission necessary discretion and mandates a course of administrative action that is at best inconsistent with the felt and openly articulated concerns that motivated the law's framers.

3. *Requiring QF's to Obtain Case-by-Case Interconnection Orders Would Cause Expensive Delays that Would Severely Inhibit their Development, Contrary to Manifest Congressional Intent.*

A construction of PURPA that permits the Commission to mandate interconnection only by orders issued on a case-by-case basis after a full adjudicative hearing would be grossly inconsistent with the policy and purpose of the Act, which even the Utilities described before the court of appeals as "Congress' mandate that the Commission remove institutional barriers to efficient cogeneration." AEP's App. Brief at 47.

The choice between case-by-case adjudication and rulemaking is a choice between delay and expedition. This Court has therefore repeatedly refused to enforce statutory language to the effect that an agency may take certain action only after opportunity for a formal hearing or other case-by-case determination when this process would compel thousands of hearings or adjudications and seriously threaten an agency's ability to implement basic statutory goals. In 1964, for example, when faced with a challenge to the FPC's authority to regulate the pricing provisions of natural gas contracts by rule, eight Justices of the Supreme Court declined to compel the "vast proliferation of hearings" that would follow a decision allowing the Commission to proceed only on a case-by-case basis, even in the face of language in the Natural Gas Act requiring the Commission to set applications of the kind in issue "for hearing." *FPC* v. *Texaco*, 377 U.S. 33, 44 (1964). Their reasoning is instructive: "We see

no reason why under this statutory scheme the processes of regulation need to be so prolonged and so crippled." 377 U.S. at 44; *see Costle* v. *Pacific Legal Foundation*, 445 U.S. 198, 215 (1980); *E. I. DuPont de Nemours & Co.* v. *Train*, 430 U.S. 112, 132-33 (1977); *Weinberger* v. *Hynson, Westcott & Dunning, Inc.*, 412 U.S. 609, 620-21 (1973).

The need to avoid the delays of case-by-case adjudication is emphasized by FERC's heavy case load. As of September 1982, FERC had a backlog of approximately 13,000 undecided cases, ranging over the entire gamut of energy-related regulatory activities, including hydroelectric license review, gas pipeline rate determinations, and natural gas producer certification and abandonment applications.[33] To add to FERC's regulatory backlog an entirely new, and potentially overwhelming, class of adjudicatory cases is sheer judicial overkill, especially at a time when both the legislative and executive branches have spoken repeatedly of the need to streamline the regulatory process.

Adjudicatory hearings are not merely time-consuming; they are also prohibitively expensive for those involved. According to one study, "the approximate direct standard cost of full private party participation in" FERC hearings totals $1,500 per hearing day. Pierce, "The Choice Between Adjudicating and Rulemaking for Formulating and Implementing Energy Policy," 3 *Hastings L.J.* 1, 16 (1979). Appellate review, when sought, is estimated to cost an additional $12,000 per active private party per proceeding. *Id.* at 17-18.[34]

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[33] These figures are drawn from a chart entitled "Summary of Pending Workload" contained in FERC's Fiscal Year 1983 Congressional Budget Request at 7-8.

[34] Cogenerators and small power producers must bear these costs themselves. A utility, of course, incorporates these expenses into its rate base, adds an appropriate rate of return, and charges the resulting amount to its customers.

An interpretation that requires FERC to engage in case-by-case interconnection in small power producer and cogenerator cases, therefore, would gut the effectiveness of section 210 of PURPA by recreating precisely the kind of institutional barriers to cogeneration and small power production that Congress determined to strike down with the passage of the Act. For this inherently practical reason, the Act should be construed in a reasonable and sensible manner to permit the Commission to set a qualifying facility interconnection policy by rule.[35]

CONCLUSION

For the reasons stated above, the judgment of the court of appeals should be reversed in its entirety and the rules vacated by that judgment reinstated.

Respectfully submitted,

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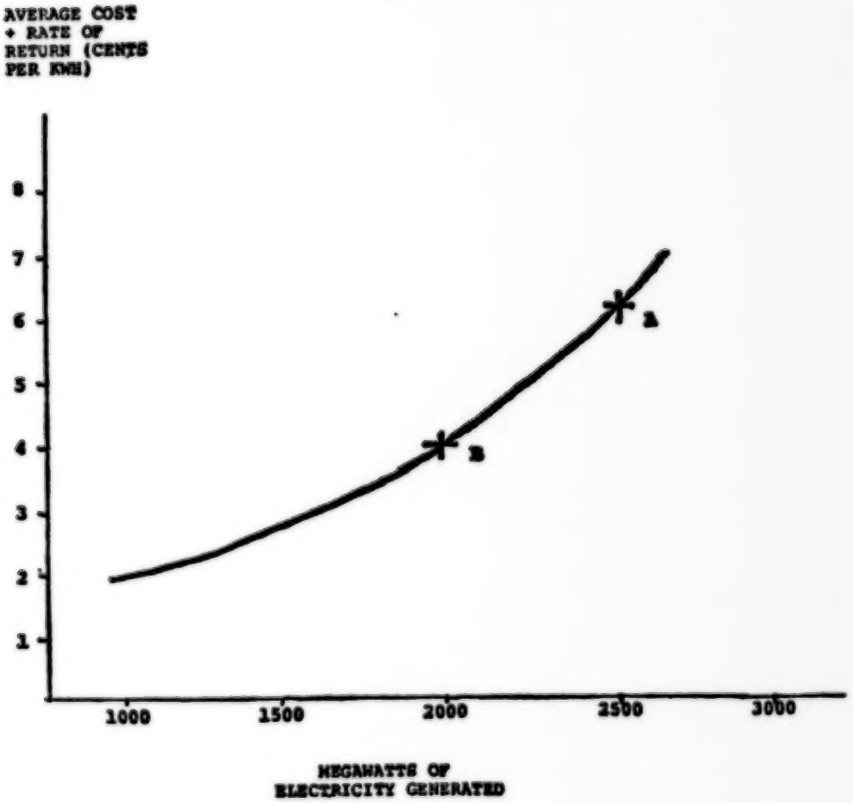
[35] The construction adopted by the Commission also comports with Congress' intent that FERC move expeditiously to establish a regulatory framework that encourages cogeneration and small power production. This intent is reflected by the language of Section 210 of PURPA that orders the FERC to promulgate QF rules within a year. Given its emphasis on the need to move rapidly to encourage the development of cogeneration and small power production, Congress could not possibly have intended to subject qualifying facilities to the delays of case-by-case adjudication.

APPENDIX A

Figure I



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In the Supreme Court
OF THE
United States

OCTOBER TERM, 1982

FEDERAL ENERGY REGULATORY COMMISSION,
Petitioner,
VS.
AMERICAN ELECTRIC POWER SERVICE CORP., et al.,
Respondents.

AMERICAN PAPER INSTITUTE INC.,
Petitioner,
VS.
AMERICAN ELECTRIC POWER SERVICE CORP., et al.,
Respondents.

On Writs of Certiorari
to the United States Court of Appeals
For the District of Columbia

BRIEF OF AMICI CURIAE NATURAL RESOURCES DEFENSE COUNCIL, INC. NATIONAL AUDUBON SOCIETY THE SOLAR LOBBY IN SUPPORT OF PETITIONERS

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No. 82-226
No. 82-34

In the Supreme Court

OF THE

United States

OCTOBER TERM, 1982

FEDERAL ENERGY REGULATORY COMMISSION,
Petitioner,

vs.

AMERICAN ELECTRIC POWER SERVICE CORP., et al.,
Respondents.

AMERICAN PAPER INSTITUTE INC.,
Petitioner,

vs.

AMERICAN ELECTRIC POWER SERVICE CORP., et al.,
Respondents.

On Writs of Certiorari
to the United States Court of Appeals
For the District of Columbia

BRIEF OF AMICI CURIAE NATURAL RESOURCES DEFENSE COUNCIL, INC. NATIONAL AUDUBON SOCIETY THE SOLAR LOBBY IN SUPPORT OF PETITIONERS

This brief in support of petitioners is submitted with the written consent of counsel to all parties filed with the Clerk of Court.

INTEREST OF THE AMICI CURIAE

This brief is submitted by three national environmental organizations dedicated to protection of the environment, to prudent use and responsible management of natural resources, and to the economic, esthetic, and social advantages that flow from decreased dependence on nonrenewable sources of energy. These organizations have a combined membership of over 550,000 contributors. A more detailed description of each amicus appears in the Appendix to this brief.

Amici have an interest in this case because both section 210 of PURPA and the Federal Energy Regulatory Commission's implementing rules are important steps toward amici's goals of creating more equitable utility rate structures and reducing the nation's dependence upon nonrenewable energy sources. In particular, the rules challenged in this case promote the deployment of renewable energy technologies which are environmentally benign compared to the conventional electrical energy generators which they displace. The amici consider vindication of the FERC rules to be crucial to a sound energy future for the nation.

SUMMARY OF ARGUMENT

In order to tap the vast reservoir of electric power potentially available from wasted heat and renewable energy sources (denominated "qualifying facilities" or "QF's"),[1] Congress commanded the Federal Energy Regulatory Com-

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[1]This term, as used herein, means "qualifying small power production facilities" and "qualifying cogeneration facilities" as defined by section 201 of the Public Utilities Regulatory Policies Act of 1978 (PURPA), 16 U.S.C. 796 (17) (Supp. IV 1980) and under 18 C.F.R. §§ 292.201-292.207 (1980).

mission ("FERC") to establish an incentive purchase rate in section 210 of the Public Utility Regulatory Policies Act of 1978 ("PURPA").

The full avoided cost rule operates only where markets do not. It is not a universal rule; it applies only in the absence of an agreement between a QF and a purchasing utility and only in the absence of a determination by a state regulatory commission that a lower rate provides a sufficient incentive.

The full avoided cost rule permits market mechanisms, where they exist, to establish prices for QF power. Where market forces are sufficient to make the full avoided cost tariff unnecessary, the states are free to prescribe another rate. Where the purchase of power from QF results in no cost advantage to the utility, it is not obliged to pay for the unneeded capacity. QF power elicited under the rule actually fosters competition with the purchasing utility that would not otherwise exist. The rule merely establishes an equitable bargaining framework under which negotiations between buyer and seller can proceed.

Nothing less than full avoided cost rates maximize cost-effective power production by QF's without raising electric rates. QF's can potentially provide the equivalent of twenty-five percent of current electrical consumption. Any lower purchase rates will retard development of these resources.

Full avoided cost rates are "just and reasonable to consumers" because they will moderate electricity prices. The resulting power from QF's will displace the most costly generators, induce utility cost reductions through competition, and reduce the costs of utility reserve margins through dispersed siting of QF's.

The rule also provides important benefits to the general public by substituting environmentally preferable power generation technologies and by decreasing the nation's reliance on foreign sources of oil.

The Court of Appeals erred in declining to accord substantial deference to the judgment of the expert agency on these points. Special deference was in order because the rule is a rate established by the agency under a novel congressional mandate and within strict limitations of time.

ARGUMENT

I

BACKGROUND

The full avoided cost rule is based on important principles of consumer equity and the public interest. This amicus brief is confined to that issue.

PURPA was a product of a widely-perceived national energy crisis.[2] The exigencies of the time were appreciated by this Court in upholding the constitutionality of PURPA last term in *FERC v. Mississippi*, ... U.S. ....., 102 S.Ct. 2126 (June 1, 1982):

> At the time [PURPA was enacted] it was said that the generation of electricity consumed more than 25% of all energy resources used in the United States. S. Rep. No. 95-442, p. 7 (1977). Approximately one-third of the electricity in this country was generated through use of oil and natural gas, and electricity generation was one of the fastest growing segments of the Nation's economy. S. Rep. No. 95-361, p. 32 (1977). In part because of their reliance on oil and gas, electricity utilities were plagued with increasing costs and decreasing efficiency in the use of their generating capacities; each of these factors had an adverse effect on rates to consumers and on the economy as a whole.

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[2]PURPA is one of five parts of a National Energy Act enacted by the Ninety-Fifth Congress as a top domestic priority of the Carter Administration. The cornerstone of the President's "National Energy Plan" was the maximum cost-effective conservation of energy in the economy, as reflected in the purposes of each of the five Energy Act components.

> S. Rep. No. 95-442, at 9. Congress accordingly determined that conservation by electricity utilities of oil and natural gas was essential to the success of any effort to lessen the country's dependence on foreign oil, to avoid a repetition of the shortage of natural gas that had been experienced in 1977, and to control consumer costs.

Id. at 2130. The nation's energy supply picture has not brightened appreciably during the intervening years.[3]

In partial response, Congress enacted section 210 of PURPA to unlock the tremendous reservoir of untapped domestic energy that is potentially available from waste heat from industrial processes (cogeneration) and renewable energy sources.[4] Section 210 commanded the FERC to prescribe "such rules as it determines necessary to encourage cogeneration and small power production," including incentive rates governing the purchase of this power by electrical utilities. Section 210 and its legislative history prescribe four rate design parameters. The rates must:

1. Be just and reasonable to the electric consumers of the utility (§ 210(b)(1));

2. Be in the public interest (*Id.*);

3. Not discriminate against qualifying facilities (§ 210(b)(2)); and

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[3]*See* DOE, *Monthly Energy Review*, at 8, 27 (Sept. 1982); R. Stobaugh and D. Yergin, *Energy Future: Report of the Energy Project at the Harvard Business School* (Ballantine ed. 1980).

[4]*See FERC v. Mississippi, supra* at 2136, where this Court focussed specifically upon section 210:

> Congress also determined that the development of cogeneration and small power production facilities would conserve energy. The evidence before Congress showed the potential contribution of these sources of energy: it was estimated that if proper incentives were provided, industrial cogeneration alone could account for seven to ten percent of the Nation's electrical generating capacity by 1987. Sen. Rep. No. 95-442 at 21, 23.

4. Be predicated upon an examination of the costs of generation experienced by the utility rather than those of the qualifying facility.[5]

Within these parameters, the Congress left to the FERC the design of appropriate rates, subject only to the further limitation that the rate not "exceed the incremental

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[5]The fourth critical parameter is derived from the Conference Report which elaborates on the "just and reasonable" standard. It evinces a congressional intent that the rate governing purchases of power from QF's not burden the QF's with the type of detailed examination of the costs of generating power that is typically applied to regulated utilities. The Conferees explain that:

> It is not the intention of the conferees that cogenerators and small power producers become subject, by virtue of this language, and the rules promulgated under this section, to the type of examination that is traditionally given to electric utility rate applications to determine what is the just and reasonable rate that they should receive for their electric power. The conferees recognize that cogenerators and small power producers are different from electric utilities, not being guaranteed a rate of return on their activities generally or on the activities vis-a-vis the sale of power to the utility and whose risk in proceeding forward in the cogeneration of small power production enterprise is not guaranteed to be recoverable.
>
> The conferees wish to make clear that cogeneration is to be encouraged under this section and therefore the examination of the level of rates which should apply to the purchase by the utility of the cogenerators or small power producer's power should not be burdened by the same examination as are utility rate applications, but rather in a less burdensome manner. The establishment of utility-type regulation over them would act as a significant disincentive to firms interested in cogeneration and small power production.

H. Conf. Rep. No. 1750, 95th Cong., 2d Sess. 97-98 (1978), *reprinted in* 1978 U.S. Code Cong. & Ad. News 7831-7832.

cost to the electric utility of alternative electric energy." (§ 210(b)).[6]

No dispute exists that the full avoided cost formula provides an ample incentive to qualifying facilities and properly avoids subjecting them to utility-type regulatory scrutiny. The Court of Appeals vacated the rule because it was not satisfied that the standard was *just and reasonable* to electric consumers and in the *public interest.*[7] The essence of the court's reasoning was:

> By ordering that the purchase rate be equal to the full avoided cost *in every case,* FERC has, without convincing explanation, simply adopted as a *uniform rule* the maximum purchase rate specified in the statute. Congress made a clear distinction between a 'just and reasonable rate' and a rate based on the full avoided cost though the two *may* coincide. It has long been held that the essence of the just and reasonable standard is a *balancing of the interests* of the affected parties. Although FERC was *not* to subject cogenerators to complex, traditional utility-type regulation, it was compelled to consider the hard questions which the standard necessarily raises.

B-10 (footnotes omitted, emphasis added).

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[6]The "incremental cost of alternative electric energy" is defined to mean "the cost to the electric utility of the electric energy which, but for the purchase from such cogenerator or small power producer, such utility would generate or purchase from another source." (§ 210(d)). This "incremental cost" is equivalent to the "full avoided cost" in the FERC rule.

[7]All citations herein to the opinion and order of the Court of Appeals will be made to Petitioner's Appendix B. (*E.g.* B-1.) The court's opinion is reported at 675 F.2d 1226 (D.C. Cir. 1982). Citations to the Commission record which was before the Court of Appeals will be preceded by the letter "R".

The Court of Appeals acknowledged that "[t]he Commission may be right in its conclusion, but it needs to make its reasoning and findings explicit." B-11. Yet the court summarily dismissed the very "reasoning and findings" recited by the agency, not because they were without support in the record, but because of the court's factual and ideological prejudices concerning rate structure and utility economics.

On remand, the court asked the FERC to take competitive forces into account "in determining the degree and type of regulation necessary." B-15. This statement is astonishing because the full avoided cost rate does exactly that.

II

THE FULL AVOIDED COST RULE IS FLEXIBLE, OPERATING ONLY WHERE MARKET FORCES DO NOT

The Court of Appeals misread the full avoided cost rule in concluding that it is a "uniform rule" which applies "in every case." Indeed, it operates more as a guarantee, applying only in those cases where a state regulatory authority or self-regulating utility does not determine that some other rate is sufficient to encourage small power production.[8] Moreover, section 210 places *no* obligation on a utility to buy unusable capacity. Capacity payments are required

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[8]Rates at less than full avoided cost are authorized for purchases of electric energy "if the state regulatory authority . . . or the non-regulated electric utility determines that a lower rate is consistent with [the statutory criteria for establishing purchase rates], and is sufficient to encourage cogeneration and small power production." 18 C.F.R. § 292.304(b)(3) (1980) B-111. Other provisions permit state regulatory authorities or non-regulated electric utilities to apply for a waiver from *any* of the FERC rules under section 210 by showing that compliance is not necessary to encourage cogeneration and small power production and is not otherwise required under section 210 of PURPA. *See* 18 C.F.R. § 292.403 (1980) B-118.

only when a utility "avoids costs" by virtue of the QF's capacity. The rules impose no requirement on the purchasing utility to deliver unusable energy or capacity to another utility for subsequent sale. *See* Section-By-Section Analysis accompanying 18 C.F.R. § 292.303 (1980), B-53.

In these respects, the FERC rule is more a guideline than a specific rate. Congress explicitly left a role for the states in defining and implementing the FERC rules, rejecting a more intrusive House bill. *See* 124 Cong. Rec. S17528 (daily ed. Oct. 7, 1978) (remarks of Sen. Jackson). The Conference Report refers repeatedly to action by "the Commission and the States." H. Conf. Rep. No. 1750, 95th Cong., 2d Sess. 98, *reprinted in* 1978 U.S. Code Cong. & Ad. News 7832. States were given substantial discretion to define and calculate avoided costs; the regulations refer to the need for "flexibility for experimentation and accommodation of special circumstances . . ." "Staff Discussion Paper," 44 Fed. Reg. 38863, 38865 (July 3, 1979). This discretion has in fact resulted in widespread variation in choices of methodology and, ultimately, in rates—variations much greater than would result from reducing avoided cost payments by five or ten percent. *See* Lock, *Statewide Purchase Rates Under Section 210 of PURPA*, 3 Solar L. Rep. 419 (1981).

Where the market pricing system is functioning to provide reasonable prices of QF's, the full avoided cost tariff becomes unnecessary and may be disregarded by the states. It must be noted, however, that section 210 was enacted in response to the perception that utilities were refusing to bargain reasonably with QF's for interconnection and the purchase of power; it is thus predicated upon a congressional assumption that market forces alone were not enough.

A. The Avoided Cost Rule Fosters Private Bargaining On Purchase Rates

The Court of Appeals overlooked the fact that full avoided cost rates do not *prevent* but in fact *facilitate* private transactions between the QF and the utility. Under 18 C.F.R. § 292.304 (1980), the full avoided cost rate is *elective;* the QF can either elect to receive payment based on the utility's avoided cost at the time of delivery *or* pursuant to an enforceable contract.[9] Section 292.301(b)(1) of the rule specifically contemplates that private bargaining will occur between qualifying facilities and electric utilities. The tariff merely establishes a framework within which bargaining can take place.

In fact, QF's have a strong incentive to negotiate agreements. Decentralized producers often lack the technical and administrative expertise that the utilities can furnish. Moreover, agreements that assure a long-term revenue flow are often indispensible to the QF in procuring financing. The avoided cost tariff guarantees a certain level of revenue for only a limited time, until the cost incidence of the utility changes. It is therefore in the interest of small

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[9]The effect of PURPA is simply to improve the bargaining position of QF's relative to the monopsony power of utilities. Section 210 shifts the burden of non-agreement from the QF to the utility, providing the QF a tariff rate to which it can resort if it believes the utility is not negotiating reasonably. *See* Lock, *Encouraging Decentralized Generation of Electricity: Implementation of the New Statutory Scheme,* 2 Solar L. Rep. 705, 717 (1980).

Small power producers testified in the rulemaking record that the monopsony power of the utilities and the lack of bargaining power possessed by developers discouraged small power production. R 2443, 2843-44, Vol. 1, 38Col. R 1186-87, 1523, Vol. 1, 186DC1, 219DC1. FERC expressly took this into account in the rules: "the ability of a qualifying cogeneration or small power producer to negotiate with an electric utility is buttressed by the existence of rights and protection of these rules." B-49.

power developers to trade away some percentage of the guaranteed tariff for a longer term commitment from the utility to purchase at an agreed rate.[10]

The full avoided cost rate provides a firm and reasonable starting point for these negotiations. Any lesser rate would simply erode the basis of the negotiations and produce a rate less optimal for QF development.

B. The Full Avoided Cost Rule Induces Competition in the Generation of Electricity

The full avoided cost rule not only allows market forces to function where they exist, it also *creates* a market which would not exist otherwise. Utilities traditionally have been the *sole* source of power for their customers. The full avoided cost rule changes this situation by encouraging alternative, private sources.

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[10]The FERC regulations explicitly recognize that the debt service obligations of qualifying facilities may require the latitude of contractual arrangements in lieu of tariff-like mechanisms.

> A facility which enters into a long-term contract to provide energy or capacity to a utility may wish to receive a greater percentage of the total purchase price during the beginning of the obligation. For example, a level payment schedule from the utility to the qualifying facility may be used to match more closely the structure of debt service of the facility. So long as the total payment over the duration of the contract term does not exceed the estimated avoided costs, nothing in these rules would prohibit a state regulatory authority or non-regulated electric utility from approving such an arrangement.

B-73.

In recent Senate hearings on section 210 of PURPA, Dr. Glenn J. Bjorklund, the Vice-President of Southern California Edison Company stated that his company has signed 60 contracts with QF's since the beginning of 1981, "nearly all of which have been negotiated at a rate below full avoided cost." *Public Utility Regulatory Policies Act Amendments: Hearings on Amendment No. 1452 to S. 1885 Before the Subcommittee on Energy Regulation of the Senate Comm. on Energy and Natural Resources*, Part 2, 97th Cong., 2d Sess. 110, 114, 131 (1982) (Statement of Dr. Glenn J. Bjorklund).

In effect, qualifying facilities compete with the purchasing utility itself as a source of power. To the extent that a utility can lower its own costs of generating power at the margin, it is obliged to pay qualifying facilities that much less under the "avoided cost" formula. If the utility can lower its marginal costs below a QF's costs of generating power, it can recapture that share of the marginal market for itself. If the purchase rate is established below the full avoided cost level, however, the utility is not subject to the same competitive pressure. The full avoided cost rule, in this way, unleashes the very market forces which the Court of Appeals feared were being fettered.

III

THE FULL AVOIDED COST RULE IS MANDATED BY THE OBLIGATION TO ENCOURAGE QF's WITHOUT SUBJECTING THEM TO PLENARY REGULATORY SCRUTINY

A. Full Avoided Costs Are Necessary for Optimal Deployment of QF's

With the rapid rise in electricity costs during the last decade,[11] the potential for cost-effective cogeneration in industry has become very large.[12] The potential for industrial cogeneration at existing plants exceeds twenty-five percent of electrical demand in the United States—equivalent to 93 large (1,000 MW) coal or nuclear power plants.[13]

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[11]Despite the slowdown in general inflation, electricity prices are still rising at an eleven percent annual rate. DOE, *Monthly Energy Review*, July 1982.

[12]This is particularly true in the petroleum, chemical, paper, food, and steel industries. *See* 3 DOE *Industrial Potential Cogeneration Source Book, Geographical/Industrial Sector Profile*, "Targeting Opportunities at the Plant Site (TOPS)" (1982).

[13]*See* Ross, *Energy Consumption by Industry*, 6 Ann. Rev. Energy 409 (1981).

The Department of Energy (DOE) projects the additional potential for cogeneration in *future* industrial facilities at 6, 11 and 14 percent of the total United States electricity consumption for the years 2000, 2010 and 2020 respectively.[13a]

The potential contribution of small-scale renewable energy systems is also impressive. Several forms, including hydropower, wind electric systems, and municipal waste combusters are now technically and economically mature. Several other technologies including generators using biomass fuels, photovoltaic cells, and solar thermal devices show great promise for the future.[14]

The amount of power from QF's that will be produced for external consumption at any time is directly a function of the price for which it can be sold to the connecting utility. As the price offered the QF is decreased from full avoided costs, the rate of return diminishes disproportionately, since the rate of return depends on the difference between revenue and cost.[15] Since the last few percentage

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[13a]*See* DOE, Energy Information Administration, *1981 Annual Report to Congress*, DOE/EIA-0173 (81)/3 at 174, 177 (1981).

[14]The Draft Environmental Impact Statement for the rulemaking process projects the following levels of small power production nationwide by 1995: Wind generation, 1900 MW; Municipal waste electricity generation, 360 MW, and Small scale hydropower generation, 3500 MW. FERC, *Draft Environmental Impact Statement*, "Rulemaking for Small Power Production and Cogeneration Facilities—Qualifying Status/Rates and Exemption," Docket No. RM-79-54, RM-55, at VII-12 (June 1980) ("DEIS").

[15]That full avoided cost rates provide the necessary investment certainly was made apparent to the FERC in the rulemaking proceedings. *See* R 1291, 2423, Vol. 1, 213 DC1, 57-58DC4. Potential investors and lenders are reluctant to commit funds unless a project demonstrates financial viability. (R 1311, 2882, Vol. 1, 86SF.) The more innovative the technology, the greater the risks to the developer. (R Vol. 1, 134Col.) If innovative projects are to be undertaken, some reward must be provided for the risk takers. (R 1309-11, Vol. 1, 181-82DC1, 185DC1. *See, e.g.*, Comments of the Hawaiian Sugar Planters Association, "the avoided costs' pricing standard . . . will constitute a necessary incentive for the production of

points of profit over operating costs will determine whether a facility is constructed and operated, a purchase rate below the utility's full avoided costs will discourage QF's that are only marginally profitable at the full avoided cost rate.

FERC's finding on this point was amply justified and clearly articulated:

> . . . in most instances, if part of the savings from cogeneration and small power production were allocated among the utilities' ratepayers, any rate reductions will be insignificant for any individual customer. On the other hand, if these savings are allocated to the relatively small class of qualifying cogenerators and small power producers, they may provide a significant incentive for a higher growth rate of these technologies.

B-65.

Any "savings" to ratepayers must come out of a QF's revenues at the margin, directly and profoundly affecting the rate of return on investment. For example, if FERC were to adopt a purchase rate at 80 percent of avoided costs (one of the alternatives suggested by the Court of Appeals), the rate of return on a cogenerator's investment would fall 40 percent for an 80 MW facility, according to a Department of Energy study.[16] This decrease in return on investment would cause an estimated reduction in cogeneration development of 50-70%, compared to the level anticipated under a purchase rate based on full avoided costs.[17]

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additional biomass power by Hawaiian sugar factories." (R 1334); testimony of the American Wind Energy Association, "payment of full avoided costs could be necessary to bring any significant amount of generation stock on line soon." (R Vol. 1, 134Col.)

[16]Resource Planning Associates, Inc., *The Potential for Cogeneration Development in Six Major Industries by 1985*, U.S. Department of Energy Contract No. CR-04-60172-00, December 1977 at Exhibit l.r.

[17]*Id.* at Exhibit l.j.

Thus, a relatively small adjustment in the price QF's receive produces disproportionately large changes in the deployment of such facilities. On the other hand, the savings experienced by the utility in purchasing QF power at less than full avoided cost must be spread among so many electrical consumers that it will become virtually undetectable.[18] And, because the benefits of QF power to ratepayers will be partially foregone, any savings to them in the short run will prove wholly illusory.[19]

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[18]The triviality of any saving to ratepayers can be illustrated by a simple hypothetical. Assume that the average price paid to QF's is 5¢/kWh, and that this reflects only 80% of the full avoided cost. Under the circumstances ratepayers would save 1.25¢/kWh. Assume FERC's estimate of 14×10^9 kWh purchased from QF's in 1985. *See* DEIS, *supra* note 14 at VII-17, Table VII-6. The total ratepayer savings nationwide of $175 million are approximately 0.2 percent of the 1980 electric utility revenues of $91.6 billion. (*Statistical Abstract of the United States*, 1981, Table 1018.) The total number of customers was 91.7 million in 1980. *(Id.)* Therefore the average savings per customer would be less than $2.00 per year. This estimated savings will result in a 50%-70% reduction in QF deployment. *See* text accompanying notes 16 and 17 *supra*.

[19]The Court of Appeals rejected FERC's reasoning on this point on the ground that "if cogeneration becomes substantial, a rate uniformly set at the statutory ceiling may be quite costly to consumers" (B-11) and that "a rate which is below full avoided cost, but still above the cogenerator's cost, could suffice to induce cogeneration. . . ." (B-14.) The court is so obviously wrong on these assertions that the agency could not be expected to provide elaborate demonstrations in anticipation of them. First, the court simply misread the rules in believing them to be uniform. (*See* note 8 *supra* and accompanying text.) Second, since avoided cost rates reflect the purchasing utility's cost savings in purchasing power from QF's they necessarily cannot cause costs to consumers to rise. Third, rates set at below full avoided costs will fail to induce QF's whose cost is above such rates to generate.

B. Alternatives Suggested By the Court of Appeals Entail Impermissible Regulatory Scrutiny

A unique merit of full avoided cost rates is that they eliminate entirely the need to scrutinize the QF's costs of generation because the full avoided costs is based wholly on the costs of the purchasing utility (which is already subject to regulation).

Congress viewed the prospect of utility-type regulation as a major disincentive to QF's. It therefore instructed the FERC to design an incentive rate which does not entail detailed examination of the QF's costs. Congress observed that, unlike electric utilities, qualifying facilities are not protected by a regulatory blanket from business risks and must therefore be assured a profit commensurate with those risks. *See* H. Conf. Rep. No. 1750, 95th Cong. 2d Sess. 97 (1978).

The Court of Appeals held that the FERC had correctly rejected a "split-the-savings approach" as excessively burdensome on QF's, but the court failed to recognize that a percentage of avoided cost approach suffers from the same problem.[20] The court apparently envisioned that FERC,

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[20]The Court of Appeals charged FERC on remand to

> allocate the benefits more evenly between the cogenerators and the utilities if the utilities can demonstrate that under a percentage of avoided cost approach, an allocation less heavily favoring the cogenerators is in the public interest and the interest of the utilities' electric consumers and will not disproportionately discourage cogeneration.

B-12. The utilities had the opportunity to make such a demonstration in the rulemaking proceeding. Instead they generally embraced the full avoided cost principle and contented themselves with urging technical and mechanical refinements:

> Con Edison and Boston Edison Company are particularly pleased that the final rules recognize that, although cogeneration and small power production is intended to be encouraged under Section 210 of PURPA, that encouragement is not to be provided at the expense of the other ratepayers of utilities, or

Solomon-style, would choose some percentage of avoided costs as the basis for a rate that allocates some of the cost savings to the utility and some to the QF. Whether the savings are to be split 50-50 (which the court correctly rejected) or according to some other ratio, the need to inquire into the qualifying facility's costs is inescapable. The percentage of full avoided costs that "appropriately" allocates the benefits cannot be determined without knowing how much it will cost to generate the alternative power. Only then can FERC calculate a sufficient profit margin or determine how much cogeneration and small power any given percentage of full avoided cost will induce.[21]

Under the court's rationale, FERC must not only scrutinize the mode and costs of operation of QF's, it apparently must do so separately for each technology and, perhaps, for each individual facility. This result follows from the fact that the costs of generation will vary widely among

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through the uneconomic encouragement of investment in unneeded generating. The final rules properly provided that utilities are not required to pay more than their avoided cost for purchases for qualifying facilities (§ 292.304(a)(2), 45 Fed. Reg. 12235) and that, where a utility has sufficient capacity to meet its demands, and purchases from qualifying facilities will not enable it to avoid any capacity costs, capacity credits for purchases from qualifying facilities are not required. (§ 292.304 (e)(3), 45 Fed. Reg. 12236).

Petition for Rehearing and Reconsideration on Behalf of Consolidated Edison Company of New York, Inc. and Boston Edison Company, p. 686 of the Joint Appendix and p. 3750 of the record.

[21]Likewise, the lower court's concern that FERC take into account differential pollution control standards and taxation rates between utilities and cogeneration invites just the sort of regulatory scrutiny which the Congress wanted to avoid. A thorough inquiry into the external benefits and disbenefits of small power production compared to conventional generation would lead to the conclusion that full avoided costs rates are overly *conservative* in view of the significant environmental and national security benefits of small power, as discussed at length *infra*. Such was the conclusion of the California Public Utilities Commision in its order implementing section 210 of PURPA. *See* note 22, *infra*.

technologies and facilities. A different percentage, therefore, would presumably be appropriate for each. Indeed, no approach other than a full avoided cost rate can be calculated wholly on the basis of the utilities' costs, without reference to the costs of the QF. Certainly the Court of Appeals was not successful in its efforts to suggest one.

IV

THE FULL AVOIDED COST RULE, BY MODERATING ELECTRIC RATES, IS JUST AND REASONABLE TO RATEPAYERS

In holding that the four parameters established for Congress for purchase rates require a "*balancing* of the interests of the affected parties," B-10, the lower court invoked an inapt metaphor which suggests that FERC should have refereed a compromise among the stakeholders—ratepayers, qualifying facilities and the general public—in order to strike a sort of equipoise. A more ideal view, however, is that PURPA envisions a rate which *optimizes* net benefits and provides maximum rewards to all stakeholders.[22] This optimization is *most* likely to be achieved by avoided cost rates.

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[22]Indeed, the California Public Utilities Commision in its Order implementing Section 210 of PURPA is strongly of the view that full avoided cost rates are the *minimum* necessary to effectuate the purpose of the law:

> Some argue that ratepayers are disadvantaged when avoided costs are paid to qualifying facilities, because in some cases these facilities can produce electricity at less than the avoided cost price. While it may be true that some QFs could be brought on line at a purchase price below avoided cost, such a price would not be sufficient to bring in other QFs capable of producing power at prices up to the avoided cost price. The point of permitting avoided cost pricing is to encourage the fullest possible efficient development of QF resources that can effectively and economically compete with utility resources. By opening this market, the supply of electricity is increased, which should lower customers' rates over time. Heavy utility reliance on oil and gas fuels to generate electricity has caused

A. The Full Avoided Cost Rate Induces Maximal Displacement of High Cost Electric Generation

Over the long run, avoided cost rates for alternative energy are likely to be more effective in reducing or moderating electrical rates than any lower rates. A utility seeks to minimize its costs of generating power by operating or building the most expensive plants last. Thus, the new power purchased from QF's will ordinarily displace the most costly source of generation or purchased power in the utility's supply mix. Least-cost dispatch assumes that the first energy source to be replaced by a QF is high-priced imported oil, just as PURPA intended. For utilities that are experiencing significant demand growth, the alternative power will eventually displace new power plants that would otherwise have to be built.[23] Such facilities are almost universally higher in cost than existing facilities.[24]

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rates in California to skyrocket. Avoided cost pricing is intended to stimulate development of substantial generating capacity that will reduce utility oil and gas consumption. In addition, system reliability is increased by the presence of larger numbers of smaller facilities.

If anything, this Commission believes that the avoided cost signal to QFs is a conservative one, as it does not include the tangible but hard to quantify "social costs" that are associated with new utility supplies and which are avoided through the purchase of QF power. These "social costs" include the risks associated with imported energy supplies and environmental degradation related to conventional generation.

Cal. P.U.C., Dec. No. 82-01-103, OIR2, at 25 (Jan. 21, 1982).

[23]In the unusual case where economics of scale cause the system-wide costs of generation to decline as new conventional capacity is added, the utility will not "avoid" capacity costs by purchasing QF power. In these cases, the full avoided cost rate will pay QF's only the value of the utility's fuel savings unless the utility chooses to wheel the power to another utility. A QF will have little incentive to locate in the service area of such a utility or to size the facility to generate power for external consumption. These cases are analogous to the overcapacity cases discussed at note 26 *infra* and accompanying text.

[24]New power plants require enormous outlays of capital which the utilities are finding increasingly difficult to raise. E Meyer,

To the extent that QF's substitute for expensive fuels and the construction of new power plants, the costs of generating power are reduced. Since these marginal sources define the utility's "avoided cost," a growth in the contribution of alternative energy will over time lower or moderate the avoided or marginal costs of providing electrical power, which should translate into lower rates for consumers.[25]

Admittedly, the situation is different for some utilities that already have more generating capacity than they need

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"New Directions for Utility Resource and Financial Planning," *Energy Efficiency and the Utilities*, California Public Utilities Commission Symposium Proceedings 139-144 (July, 1980). Because the lead time for new power plants can range as high as twelve years, the debt service on borrowed funds contributes substantially to the high cost of new capacity. Utilities which rely on projects with long lead times to meet anticipated future demand also incur the risk that the projects may prove unnecessary or obsolete. This occurred with the Washington Public Power Supply System. Declining forecasts of the need for power, coupled with cost overruns, forced the cancellation of two nuclear units on which $2.25 billion had already been spent. Nichols, *WPPSS—A Postscript*, Pub. Util. Fort. (June 24, 1982) at 54. Thus, the full avoided cost rate will result in an improvement in the financial condition of the utility because unnecessary capital investment can be avoided. Utilities have explicitly adopted the goal of minimizing capital expenditures to improve their financial status. *See* Pacific Gas and Electric Company, *Statement of Key Corporate Goals and Direction, Long Term Planning Results 1982-2000*, (June, 1982). Purchasing power under PURPA is an element of this strategy. The economic benefit to electricity consumers of lower cost of debt and equity is significant. *See* National Economic Research Associates, Inc., *An Economic Evaluation of the Marble Hill Nuclear Project*, Indiana Public Service Commission Cause No. 36818 at IV-17, 18 (October 4, 1982).

[25]The restraining effect on utility rates was apparently in mind as FERC developed the full avoided cost rule:

> Under the principles of economic dispatch, utilities generally turn on last and turn off first their generating units with

to meet demand in the present or near future. This situation gives rise to the theoretical problem which vexed the Court of Appeals:

> If a utility has excess capacity the additional cogeneration encouraged by full avoided cost payments will result in higher costs for all remaining customers of the utility because that cogeneration will reduce the number of customer-purchased kilowatt hours over which the utility can spread a share of the fixed costs of that extra capacity.

B-13. But this hypothetical misconstrues the application of the full avoided cost principle. If the avoided capacity costs on a system are small or nonexistent, so will be the incentive to QF's. Cogenerators, for instance, will either locate in a more conducive utility service area or size their facilities to serve only their own internal needs, rather than to sell power to the interconnecting utility because the incremental cost of additional generation will not be justified by the low rates predicated upon the utility's cost saving.[26]

B. The Full Avoided Cost Rate Induces Utility Cost Reductions Through More Efficient Use of Resources

We have noted above that the full avoided cost formula stimulates competition between utilities and QF's as to

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> the highest running cost. At any given time, an economically dispatched utility can avoid operating its highest-cost units as a result of making a purchase from a qualifying facility.
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> • • • •
>
> [Power from a QF can] permit the purchasing electric utility to avoid the need to construct a generating unit, to build a smaller, less expensive plant, or to reduce firm power purchases from another utility, [and] the rates for such a purchase will be based on the avoided capacity and energy costs.

B-44.

[26] *See, e.g.*, Testimony of William A. Hawkins of Consolidated Edison Company of New York before the New York Public Service Commission in Case 27574 at 4 (1980).

the marginal supply of power. This competition exercises a restraint on utilities' resource expansion plans. The present and prospective availability of qualifying small power makes expensive new capital projects harder to justify without risking excess capacity.[27] This salutory competition, operating outside the usual regulatory constraints, will lead to more efficient use of resources by utilities and lower rates for consumers.

Small-scale dispersed generators also promote greater system reliability, decreasing a utility's need for reserves. The chances of an aggregate of 1,000 MW of small generators going off line unexpectedly are negligible compared to the chances of an unplanned outage of a single 1,000 MW central generating station. This decreased need for standby capacity translates into cost savings to a utility.[28]

All of these benefits to ratepayers—decreased cost of capacity additions, greater resource efficiency through competition, and decreased need for reserve capacity due to greater reliability—are directly correlated to the degree of penetration of cogeneration and small power production in the nation's electricity markets. Full avoided cost rates provide the maximum financial incentive for the construc-

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[27]Regulatory commissions have shown an increasing propensity to penalize utilities for unused capacity resulting from imprudent expansion decisions. *See, e.g.*, Iowa State Commerce Commission, *In re Iowa Illinois Gas and Electric Company*, RPLI-81-5, May 18, 1982; Ohio Public Utilities Commission, *Re Dayton Power and Light Co.*, Case No. 81-#L-AIR, 45 PUR 4th (Feb. 3, 1982); North Dakota Public Service Commission, *Re Otter Tail Power Co.*, Docket No. 10,124, 44 PUR 4th (July 20, 1981); Missouri Public Service Commission, *Re Kansas City Power and Light Co.*, Case No. ER-80-48, 38 PUR 4th (June 19, 1980).

[28]R. Deb and J. Mulvaney, "Economic and Engineering Factors Affecting Generating Unit Size," *IEEE Trans. on Power Apparatus and Systems*, V. PAS-101, No. 10 (October, 1982) 3907-3918. V. Loose and T. Flaim, "Economics of Scale and Reliability: The Economics of Large vs. Small Generating Units," 4 *Energy Systems and Policy*, Nos. 1 and 2 at 37-55 (1980).

tion and operation of such facilities without increasing costs to electrical consumers. Any lower rate, whether based upon a percentage of full avoided cost or some other formula, would discourage some substantial percentage of such facilities.[29]

V

THE FULL AVOIDED COST RULE IS IN THE PUBLIC INTEREST

The Court of Appeals was unconvinced that the full avoided cost rule meets the requirement that purchase rates be "in the public interest." (B-9.) To be non-redundant, this standard must comprehend public benefits beyond the rate benefits to particular customers. Many public interests may be affected by the emergence of alternative energy systems, but two benefits are particularly noteworthy because they were much on the minds of the members of Congress in enacting PURPA. These involve environmental quality and energy security.[30]

A. The Full Avoided Cost Rate Produces Important Environmental Benefits

The beneficial environmental impacts of cogeneration and small power production were discussed by the agency in the environmental impact statement on the proposed rules.[31] The impact statement found that "[o]ne of the major environmental benefits brought about by the operation of facilities induced by PURPA will be to reduce effects that otherwise would have occurred through con-

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[29] *See* note 18, *supra* and accompanying text.

[30] *See, e.g.*, H. Rep. No. 543, 95th Cong., 2d Sess. 5 (1978):

> The fundamental problem for the U.S. energy policy is the insecurity of its oil supply. . . . Our reliance on imported oil is expected to increase dramatically if present practices and policies are continued. . . . Such an increase in our reliance on oil imports would greatly constrain our foreign policy and could do considerable damage to our economy.

[31] DEIS, note 14 *supra*.

ventional utility power generation." DEIS at VI-30.[32] This statement projects that between 1980 and 1995, the full avoided cost rule will defer 5400 MW of coal-fired generation, 1200 MW of nuclear power, 3300 MW of oil and gas-fired generation, and 290 MW of large-scale hydropower. *Id.* at VI-18. Each of these generating technologies imposes substantial and controversial environmental costs at each step of its fuel cycle, from fuel extraction through combustion and waste disposal. The DEIS shows that for each new 1000 MW coal plant, 200,000-300,000 pounds per day of air pollution will be produced, depending upon the region in which it is located. *Id.* at VII-32, Table VII-13. Again, depending on the region, such a plant will produce between 1000 and 3700 tons of solid waste per day. *Id.* at VII-33, Table VII-4.

These substantial environmental costs detract from human health and quality of life. Small power production avoids or greatly reduces these costs[33] creating public benefits that militate strongly in favor of maximum stimulation of QF development.

B. The Full Avoided Cost Rate Enhances Energy Security

The other public benefit foremost in the minds of the Congress in enacting PURPA was the effect upon the

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[32]The advantages of cogeneration include the enhanced efficiency with which it uses fuel reserves compared to conventional generation. Cogeneration requires but one-half as much fuel to produce the same electricity as is required in a single purpose electricity generating station. R. Williams, *Industrial Cogeneration*, 3 Ann. Rev. Energy 313 (1978).

[33]To be sure, small power produces some untoward environmental effects as well. Cogenerators, for instance, cause a certain amount of air pollution. However, these effects were judged by the Commission to be sufficiently small compared to the important environmental benefits of small power to lead the Commission to conclude that "[t]he overall development of QFs will not have a significant effect on the quality of the human environment within the meaning of Section 102 of NEPA." DEIS at I-6.

nation's vulnerability to supply interruptions and price escalations from foreign sources of energy. As PURPA was being debated, the nation was importing 8.5 million barrels of oil per day—nearly half our needs—at fifteen times the price charged only a few years before, and domestic oil production was in decline.[34] The vulnerability associated with this external dependence can be measured by assessing the consequences to the national economy should the supply be preemptorily terminated. The Congressional Budget Office estimates that the loss of oil from one foreign supplier alone, Saudi Arabia, would cost the United States $272 billion, increase the unemployment rate by two percent, and boost the inflation rate by twenty percentage points.[35] The disruption of America's chief military allies would be even greater. This concern has given rise to open discussion of war to secure oil routes out of the Persian Gulf. President Carter called the situation "a clear and present danger to our national security."

While we do not maintain that PURPA, however vigorously implemented, can eliminate oil imports alone or immediately, the public benefit of enhanced energy security is furthered in direct proportion to the rate of deployment of qualifying facilities. The maximum financial incentive permitted under PURPA—full avoided cost—is the rate that best satisfies the "public interest" design parameter. This conclusion is too apparent to require extensive analysis in the decision-making record or explicit discussion in the Section-by-Section Analysis of the rules. It would be absurd to remand this case to the agency for it to state what no one can credibly dispute.

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[34]*See* Deese and Nye, *Energy and Security* 3 (Ballinger 1981).

[35]Congressional Budget Office, *The World Oil Market in the 1980's: Implications for the United States* (1980).

VI

THE FULL AVOIDED COST RULE, AS A RATE INNOVATION, WARRANTS GREATER THAN ORDINARY JUDICIAL DEFERENCE[36]

In a typical case of judicial review of agency rulemaking, a "thorough, probing, in-depth review" is proper under the instructions set forth by this Court in *Citizens to Preserve Overton Park v. Volpe*, 401 U.S. 402, 415 (1971).[37] In conducting such a review, the Court of Appeals failed to appreciate the unique features of this case. Judicial review of rate cases proceeds subject to a rule of special deference to the expert judgment of the decision-

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[36]Much debate has been joined in this litigation over the proper standard of review. *See* FERC Petition for Cert. at 22; American Paper Institute Petition for Cert. at 4, 16-20; Opposition to Petition for Cert. at 9-12. No real difference exists between the "substantial evidence" standard and the "arbitrary and capricious standard" in practice, especially in regard to informal rulemaking, as both the District of Columbia Circuit and the Second Circuit have recognized. *See American Public Gas Association v. Federal Power Commission*, 567 F.2d 1016, 1026-29 (D.C.Cir.) *cert. denied*, 435 U.S. 907 (1977); *Associated Industries of New York v. Dept. of Labor*, 487 F.2d 342, 348-350 (2d Cir. 1973).

[37]*Overton Park, supra*, established a three-part test. First, the court is "required to decide whether the Secretary acted within the scope of his authority." *Id.* at 415. Involved in this inquiry is "a determination of whether the Secretary's decision can reasonably be said to be within that range set forth by Congress." *Id.* Section 210 of PURPA established a range within which the rate for purchases of power is to be set, namely that it shall not "exceed the incremental cost to the electric utility of alternative energy." Clearly, the avoided cost rule does not *exceed* this point.

Secondly, a finding must be made that "the actual choice made was not 'arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law.'" *Id.* at 417. An examination of the over 4,000 pages of the record below amply illustrates that the decision was "based on relevant factors" and that "there has been [no] clear error of judgment." *Id.* The Court of Appeals could only conclude that the legislation *"could"* fail to induce additional cogeneration and *"might"* leave customers worse off. At the same time, the Court

making agency. This principle applies *a fortiori* where, as here, the rate is developed in response to a novel and experimental congressional mandate and subjected to tight and strict time constraints.

A. The Avoided Cost Rule is Valid Under the Special Deference Due Ratemaking

The instant case is steeped in the economics of rate-setting. This Court and many others have recognized that FERC's regulation of rates under the "just and reasonable" standard is due considerable deference. *See Atchison, Topeka & Santa Fe Ry. v. Wichita Bd. of Trade,* 412 U.S. 800, 806 (1973) (quoting *Manufacturers R. Co. v. United States,* 246 U.S. 457, 481 (1918) and *Board of Trade of Kansas City v. United States,* 314 U.S. 534, 546 (1942)). *See also San Antonio, Texas ex rel. City Public Service Board v. United States,* 631 F.2d 831, 836 (D.C. Cir. 1980).

Justice Douglas recognized the special status of ratemaking, from the standpoint of judicial review, in a case involving an order setting rates on coal:

> Rate structures are not designed merely to favor the revenues of producers and carriers. The Commission has the consumer interest to safeguard as well. And when it undertakes to rationalize the interests of the three, great complexities are often encountered. The economics of the bituminous coal industry have baffled even experts. We would depart from our competence and our limited function in this field if we undertook to accommodate the factors of transportation conditions, distance and competition differently than the Commission has done in this case. That is a task peculiarly for it. In fashioning what the Commission called a dif-

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admitted that the Commission "*may* be right in its conclusion. . . ." B-38, B-11.

Third, "the final inquiry is whether the Secretary's action followed the necessary procedural requirements." Whether the proper procedures were followed is not at issue in this case which invalidated the avoided cost rule on substantive, not procedural, grounds.

> ferentially related and finely balanced rate structure for this coal, there is no place for dogma or rigid formulae. The problem calls for an expert, informed judgment on a multitude of facts. The result is that the administrative rate-maker is left with broad discretion as long as no statutory requirement is overlooked. Yet that is, of course, precisely the nature of the administrative process in this field.

Ayrshire Collierres Corp. v. United States, 335 U.S. 573, 592-93 (1949).

More recently, in *Permian Basin Area Rate Cases,* 390 U.S. 747 (1968), this Court had occasion to discuss in detail the scope of judicial review of rates set by the Federal Power Commission, the predecessor agency to the Federal Energy Regulatory Commission. The Court quoted the following passage from *Permian Basin* in *Mobil Oil Corp. v. FPC,* 417 U.S. 283, 307-308 (1974) as the "criteria governing the scope of judicial review":

> *The court's responsibility is not to supplant the Commission's balance of these interests with one more nearly to its liking, but instead to assure itself that the Commission has given reasoned consideration to each of the pertinent factors.*

Id. at 283, quoting *Permian Basin, supra* at 791-92 (emphasis in original).

The rule set forth by this Court is that a reviewing court is "not obliged to examine each detail of the Commission's decision: if the 'total effect of the rate order cannot be said to be unjust and unreasonable, judicial inquiry under the Act is at an end.'" *Permian Basin, supra* at 767, quoting *FPC v. Hope Natural Gas Co.,* 320 U.S. 591, 602 (1944). *See also Mobil Oil, supra* at 307. The Court has recognized that where Congress has invested an agency with general responsibility for administration of a complex regulatory scheme, the agency's interpretation of its statutory charter is entitled to special deference. *EPA v. National Crushed Stone,* 449 U.S. 64, 83 (1980).

It is clear on the face of the Court of Appeals' opinion that its real quarrel was not with the methods the Commission used but rather the "balance of interests" it struck. The above discussion illustrates that the Court of Appeals was simply mistaken on the facts and the record. Its contrary view was an improper substitution of its judgment for that of the Commission.

B. Judicial Deference is Also Appropriate Here in View of the Congressional Command for a Novel and Unprecedented Regulatory Initiative

FERC's decision warrants deference for another reason. PURPA marks a substantial departure from the traditional utility monopoly over generation of electricity. *See, e.g.*, 123 Cong. Rec. 23848 (daily ed. Aug. 1, 1977) (remarks of Sen. Percy); 123 Cong. Rec. at 32403 (Oct. 5, 1977) (remarks of Sen. Dunkin); *id.* at 32437, (remarks of Sen. Haskell); *id.* at 32419 (remarks of Sen. Hart). It calls for a fundamental reordering of the traditional regulatory scheme. Uniquely, it gives FERC authority over retail sales of power (from utilities to qualifying facilities as back-up power). Uniquely, it also gives states regulatory authority over sales for resale (power sales from QF's to utilities). Uniquely, it requires customers (utilities) to buy power from any QF. Incentive rates to encourage certain modes of power *consumption* are familiar, (*e.g.*, peak load pricing), but here FERC is required to prescribe rates which encourage certain types of *generation*. While the establishment of rates for electricity on the basis of the seller's cost is familiar regulatory terrain, Congress' desire to have rates based on a buyer's avoided costs is new ground.

Congress mandated these radical departures because of the substantial benefits of privately-financed cogeneration and small power producers. Yet, because of the pressing energy problems facing the country, Congress wanted the section 210 program implemented very quickly; FERC was given only twelve months to promulgate regulations. *See*

§ 210(a). Given the scope and complexity of the issues raised and the limited time in which to consider them, FERC could hardly be expected to make all its determinations with algebraic precision. *See Illinois v. Gorsuch*, 530 F.Supp. 340 (D.D.C. 1981) (Short time frame is evidence that "Congress did not expect the agency to resolve every conceivable problem.").

Courts have accorded an even greater degree of judicial deference, "[w]hen regulation features novelty, in subject, technique, or both," as another panel of the Court of Appeals for the District of Columbia stated in *American Public Gas Ass'n v. FPC*, 567 F.2d 1016, 1031 (D.C. Cir.), *cert. denied*, 435 U.S. 907 (1977). *See also Shell Oil Co. v. FPC*, 520 F.2d 1061, 1071 (5th Cir. 1975), *cert. denied sub nom. California Co. v. FPC*, 426 U.S. 941 (1976) ("kid glove" review appropriate because of "experimental nature of regulation"); *Kennecott Copper v. EPA*, 462 F.2d 846 (D.C. Cir. 1972).

Because of the novelty of this exercise, history provides few guideposts. The amount of power that will be produced or withheld at any specific rate is a matter for educated conjecture. The effects on ratepayers of various levels of QF penetration is necessarily speculative.[38] Informed parties may earnestly disagree concerning the point of exact equilibrium among competing interests.

The FERC has emerged from this regulatory minefield with a formula which is logical, workable and within the range of options established by Congress. The full avoided cost role is the product of extensive and well-reasoned staff discussion papers, a formal environmental impact review, voluminous public comments garnered in two comment periods and 8 public hearings in 5 locales. All of this

[38]The FERC was aware that, because of the time constraint and because of the novelty of the program, the rules would of necessity be experimental and require review and revision as data from actual experience became available. *See, e.g.*, R 1249, 1312, 2477, 2786, Vol. 1, 146-47 DC4.

was accomplished within the tight time constraint of one year from enactment of PURPA, as required under section 210.[29]

Yet the Court of Appeals was not satisfied. In demanding absolute precision and quantification for the full avoided cost rule, the court applied a standard which no agency could hope to meet under comparable circumstances. Had the FERC adopted a "percentage of avoided cost" rule, the apparent preference of the Court of Appeals, it would manifest the same infirmities, as would any other formula. The only likely result of such a standard of review is regulatory paralysis and the practical demise of an important national energy program. PURPA is a novel and experimental program entrusted to FERC, and is thus entitled to more deference than a routine delegation of rulemaking power.

CONCLUSION

The order of the Court of Appeals for the District of Columbia should be reversed on the full avoided cost issue.

Respectfully submitted,

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(Appendix Follows)

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[29]Courts also recognize a special deference to agency decisions when they must be made within a short time frame. *See, e.g., E. I. du Pont de Nemours & Co. v. Train*, 430 U.S. 112, 134-135 (1976); *Train v. Natural Resources Defense Council*, 421 U.S. 60, 87 (1975); *Weyerhauser Co. v. Costle*, 590 F.2d 1011 (D.C. Cir. 1978).

APPENDIX

DESCRIPTION OF AMICI

Natural Resources Defense Council, Inc., a national environmental organization with more than 44,000 members residing in all states and territories, as well as abroad, has as one of its principal goals the preservation and wise use of the natural resources of the earth, including those resources such as clean air and clean water held in common by all people. NRDC has sought, through the advocacy of effective federal, state and local laws, to assure that those commonly held resources are protected.

The National Audubon Society is one of the oldest, largest and most experienced national conservation organizations. It is devoted to conservation and protection of the natural environment which supports both humankind and wildlife. The National Audubon Society's 470,000 members in 425 chapters are backed by a full-time staff of 200 working in ten regional offices. The staff includes scientists and other professionals specialized in energy policy. In April, 1981, the Society published the Audubon Energy Plan in which cogeneration and small-scale power production are key elements in furthering the Society's purpose of promoting wise and efficient use of energy resources.

Solar Lobby is a not-for-profit organization with more than 40,000 members across the United States, in the U.S. territories, and in other countries. Solar Lobby's purpose is to take nationally focused political action to achieve the rapid, substantial, and widespread use of solar energy in an energy-efficient, environmentally sound, and equitable society. The staff of the Solar Lobby works nationally and through affiliate groups around the United States to ensure a rapid transition to a society based on renewable energy resources and energy efficiency with an emphasis on decentralized approaches to solving our energy needs. This organization envisions a society that obtains twenty-five percent of its total energy needs from renewable resources by the year 2000. Solar Lobby's national office is located in Washington, D.C. The organization's Media Project is located in Los Angeles, California.

(SHOW 3 PROCEEDINGS
AND ORDERS DATE: 033083

CASE NBR 82-1-00034 CFX

SHORT TITLE Am. Paper Institute DOCKETED: Jul 8 1982

VERSUS Am. Elec. Power, et al.

Date	Proceedings and Orders
Jul 8 1982	Petition for writ of certiorari filed.
Jul 8 1982	Appendix of petitioner Am. Paper Institute, Inc. filed.
Jul 21 1982	Order extending time to file response to petition until September 6, 1982.
Jul 28 1982	Brief of Elizabethtown Gas Company in support of petitioner filed.
Sep 7 1982	Brief of respondent Am. Elec. Power et. al. in opposition filed. VIDED.
Sep 15 1982	DISTRIBUTED. October 8, 1982
Oct 12 1982	Petition GRANTED. The case is consolidated with 82-226 and a total of one hour is allotted for oral argument. Justice O'Connor OUT.
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Nov 19 1982	Order extending time to file brief of petitioner on the merits until December 6, 1982.

CONTINUE (

(SHOW) PROCEEDINGS AND ORDERS DATE: 033083

CASE NBR 82-1-00034 CFX

SHORT TITLE Am. Paper Institute DOCKETED: Jul 8 1982

VERSUS Am. Elec. Power, et al.

Date	Proceedings and Orders
Nov 19 1982	Order extending time to file brief of respondent on the merits until January 11, 1983.
Dec 6 1982	Brief amicus curiae of Natural Resources Defense Council filed. VIDED.
Dec 6 1982	Joint appendix filed. VIDED.
Dec 6 1982	Brief amicus curiae of Diamond Shamrock Corp. et al., filed. VIDED.
Dec 6 1982	Brief of respondent F.E.R.C. filed. VIDED.
Dec 7 1982	Brief of petitioner Am. Paper Institute, Inc. filed. VIDED.
Dec 6 1982	Brief of respondent Elizabethtown Gas Company in support of petition filed. VIDED.
Dec 7 1982	Brief amicus curiae of Kerr-McGee Chemical Corp, et al. filed. VIDED.
Dec 20 1982	Motion of the Solicitor General for divided argument filed.

CONTINUE (

CASE NBR 82-1-00034 CFX
SHORT TITLE Am. Paper Institute DOCKETED: Jul 8 1982
VERSUS Am. Elec. Power, et al.

Date	Proceedings and Orders
Jan 10 1983	Motion of the Solicitor General for divided argument DENIED. Justice O'Connor OUT.
Jan 11 1983	Brief of respondent Am. Elec. Power et. al. filed. VIDED.
Jan 11 1983	Motion of Edison Electric Institute for leave to file a brief as amicus curiae filed.
Jan 25 1983	CIRCULATED.
Feb 10 1983	Record filed.
Feb 10 1983	Certified original record & C.A. proceedings, (Box), received.
Feb 15 1983	SET FOR ARGUMENT. Tuesday, March 22, 1983. (2nd case) The case is consolidated with case No. 82-226. (1 Hour)
Feb 22 1983	Motion of Edison Electric Institute for leave to file a brief as amicus curiae GRANTED.
Mar 11 1983	Reply brief of petitioner Am. Paper Institute, Inc. filed. VIDED.

CONTINUE (

CASE NBR 82-1-00034 CFX
SHORT TITLE Am. Paper Institute DOCKETED: Jul 8 1982
VERSUS Am. Elec. Power, et al.

Date	Proceedings and Orders
Mar 15 1983	Reply brief of petitioner Federal Energy Regulatory Com. filed. VIDED.
Mar 22 1983	ARGUED.